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The Conference Board

Report Number 981

Long Term Care: A New Employee Benefit?

Senior executives discuss:

- *current models of group long term care insurance*
- *key issues in deciding whether to sponsor a group plan*
- *customized insurance products for different employee populations*
- *outlook for employer-sponsored plans*

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Long Term Care: A New Employee Benefit?

by Victor S. Barocas

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From the President

Today's corporate leaders are rethinking their approaches to employee benefits as a result of many factors, including a longer-lived population, an increasingly diverse work force, escalating health care costs, and government involvement with human resource policies. With fewer dollars available for employer-paid programs, many companies are sponsoring employee-pay-all options to help employees plan for their own future.

Long term care is emerging as one of those new benefits. This report examines how and why companies are implementing employer-sponsored long term care, the options currently available in group long term care insurance products, and the factors that influence employer decisions.

The Conference Board appreciates the support of the insurance carriers and companies who provided detailed information about their programs and spoke candidly about the current status and future prospects for long term care as an employee benefit.

PRESTON TOWNLEY
President and CEO

Executive Summary

Employer-sponsored long term care is emerging as a new employee benefit for the 1990s. The past five years have seen a rapid growth in the long term care marketplace in general, and employer-sponsored plans in particular. The impetus for the growth is the interaction of several demographic and business forces, including:

- Changing demographics, such as an increasing number of older workers and longer-lived elderly who will likely require long term care assistance.
- Growing numbers of employed caregivers who are responsible for providing elderly relatives with financial and/or caregiving assistance.
- Recognition that most existing employer-sponsored benefit packages are inadequate to protect employees and their families against risks associated with long term care.
- Escalating human resource costs, especially health-related benefits, resulting in revised benefit packages.

The insurance industry, seeing the aging population as a potential new marketplace, has responded with group long term care products. Today, employer-sponsored long term care insurance is available to employees, their spouses, parents, and, generally, to retirees and their families. Long term care plans are portable, and eligible participants can receive assistance in community or nursing home facilities, with eligibility based upon a standardized assessment tool.

Group long term care products have undergone significant refinement during their brief history: inflation protection, case management, death benefits and nonforfeiture provisions are among the new plan offerings and options. Underwriting and pricing long term care is especially difficult because this product is a hybrid containing elements of health, disability and life insurance, as well as deferred compensation. Moreover, long term care does not have the history associated with more traditional employee benefits. It is expected that all aspects of long term care insurance, from plan design to services offered and plan administration, will be continually improved as experience with the product increases and corporate interest in long term care grows.

Method

This report is based upon in-depth individual and group interviews, a literature review, and analysis of printed plan descriptions provided by executives from 24 large corporations. The sample of participating companies was selected to represent three categories: (1) insurance carriers marketing a long term care product; (2) companies that currently sponsor a long term care plan for employees; and (3) companies that are considering plan sponsorship. Carriers and companies were selected to represent a variety of approaches to long term care insurance products and plan designs.

Executives from insurance companies were interviewed about their long term care product: how it developed and their perceptions of the long term care marketplace. Corporate executives were asked individually to evaluate their experiences with group long term care products, to discuss long term care in relation to other employee benefits, and to identify facilitators and barriers to plan sponsorship. Additionally, three group interviews were conducted with senior benefits executives to discuss the future of employer-sponsored long term care from both a corporate benefits and public policy perspective. A literature review, analyses of detailed plan descriptions, and interviews with industry experts supplemented the interview research.

Companies that provided interviews include: The Aetna Life and Casualty Company; Air Products and Chemicals, Inc.; American Express Travel Related Services Company, Inc.; AT&T Co.; Avon Products, Inc.; BankAmerica Corp.; BASF Corporation; CIBA-GEIGY Corp.; CBS Inc.; First Interstate BanCorp, Inc.; IBM Corp.; John Hancock Mutual Life Insurance Company; Merck & Co., Inc.; Metropolitan Life Insurance Company; Motorola, Inc.; The Procter & Gamble Company; Quantum Chemical Corporation; and The Travelers Corporation. Two participant companies requested anonymity.

Many employers have implemented plans or are seriously considering group-sponsored long term care as an addition to their benefit package. They view it as a natural complement to existing benefit packages and, through employee-pay-all plans, as a way to help employees assume greater responsibility for their own future financial and retirement planning. Long term care is also seen as one element of an integrated corporate work-family initiative.

While generally positive about long term care's promise, employers are concerned about premium costs, the impact of inflation upon long term care benefits, and the legislative environment. Further, current and potential plan sponsors recognize that this employee benefit is significantly different from other benefits. Introducing a plan requires strong commitment and preparation time, including understanding the benefit, selecting a vendor, tailoring a plan to the sponsor's demographics and benefit package, and educating employees. Lastly, sponsors indicate concern about the many unknowns of long term care, the greatest of which is ensuring that plan premiums remain affordable. To date, there is limited information on claims by plan participants.

In order for widely accessible employer-sponsored care to become a reality, employers, the insurance industry, and government all have a role to play. The goal is to create an environment that will foster employer sponsorship and facilitate enrollment by eligible employees and their families. Specific responsibilities for:

- *Employers*—educate employees about the need for long term care insurance; design plans that encourage enrollment; and communicate company plans as models to the general public and other employers.

- *Insurance Industry*—design affordable long term care products; demonstrate an ongoing commitment to long term care; and develop products tailored to the group market.

- *Government*—clarify ambiguities in current tax laws; assume a leadership role to educate the public on the realities of long term care; and enact legislation to facilitate the growth of corporate-sponsored plans.

How employer-sponsored long term care evolves in the next few years depends greatly upon successful interaction among these groups.

Glossary of Terms

Activities of Daily Living. Activities that people who live independently do every day of their lives—eating, bathing, using a toilet, dressing, moving from one place to another, and transferring from bed to chair.

Acute Care. Medical care required for a short period of time to cure a specific illness.

Adult Day Care Centers. Centers providing social, recreational, and rehabilitation services to people unable to care for themselves independently during the day but able to live at home at night.

Assisted Living Facilities. Facilities for those not requiring nursing care but requiring daily assistance with activities such as eating, bathing, dressing, mobility and continence.

Benefit Eligibility. Prerequisites for receiving benefits. Generally based on Activities of Daily Living.

Board and Care Homes. Facilities providing room, meals, help with Activities of Daily Living, and some degree of protective supervision.

Care Advisor. Geriatric professionals who help individuals develop a care plan, identify appropriate services/providers, and monitor care.

Chronic Care. Medical or custodial care required for a long period of time.

Custodial Care. Care primarily for personal needs, like walking, bathing, dressing or eating; can be provided by individuals without professional medical skills or training.

Death Benefit. Allows return of premium payments to a beneficiary or to the participant's estate.

Guarantee Issue. Guarantees plan participation without medical certification.

Guaranteed Renewable. Ensures coverage; cannot be canceled as long as premiums are paid.

Inflation Protection. Provision for periodic increase of coverage and maximum daily benefit to reflect increasing costs of care based upon CPI or other economic indicators; medical underwriting not generally required.

Informal Caregivers. Family members or friends who provide care without pay.

Intermediate Care. Doctor-ordered nursing and rehabilitative care performed by licensed professional.

Long Term Care. Assistance provided over a period of time for those who are unable to care for themselves independently; includes range of services from skilled nursing to custodial care.

Maximum Daily Benefit (MDB). Dollar amount allowable for paid benefits during each day of eligibility.

Maximum Lifetime Benefit (MLB). Maximum dollar amount for each option, equal to a multiple (generally three-to-five years) of the daily benefit amount. For example, if the daily benefit amount is $100, then the maximum benefit is $182,500 (1,825 x $100).

Medicare. Federal government insurance program to assist those over age 65 with medical and hospital expenses; covers only skilled care in a skilled nursing facility; does not cover long term care.

Medigap Policies or Medicare Supplement Insurance. Private insurance policies to supplement Medicare; covers co-payments and deductibles; usually does not cover LTC services like custodial care.

Medicaid. Welfare program administered by each state and supported by federal and state funds; provides health insurance to eligible, low income individuals.

Nonforfeiture of Benefits. Guaranteed access to benefits after participating in plan for a specified period of time.

Paid up Premium. Payment schedule whereby participant prepays for lifetime coverage.

Portability. Option to continue coverage if employee leaves the sponsoring company.

Pre-existing Condition. Medical advice or treatment received from a health care provider during a specified period prior to the participant's effective date of coverage.

Respite Care. Time off or "respite" for informal caregivers who regularly provide care for a chronically dependent person.

Return of Premium. See Death Benefit.

Significant Activities of Daily Living (SADLs). See Activities of Daily Living

Skilled Care. Doctor-ordered care provided by a Registered Nurse or rehabilitation therapist.

Skilled Nursing Facility. Room, board and 24-hour skilled nursing care.

The Growing Need for Long Term Care

"We designed pension, savings and health plans to help our employees plan for their retirement; however, we learned long term care could eliminate their savings and our best intentions."

—vice president of benefits, communications company

Who will pay for long term care? Corporate executives, benefits professionals, insurance companies, employees, retirees, elected representatives and the media are all grappling with this question. In contrast to acute care, long term care is not covered by most existing employer-sponsored benefits. Concern about the high cost of long term care threatens the productivity of active employees and the economic security of active and retired employees alike.

Long term care includes a broad spectrum of health and social services provided to individuals who cannot function independently due to chronic, irreversible or degenerative physical or mental disorders. Care requirements usually increase over time and, contingent upon the illness, vary greatly.

Consumers and Providers

Currently, over 7.5 million of America's 30 million adults over the age of 65 require some form of long term care assistance, and some 1.5 million elderly reside in institutional settings. As age increases, the likelihood of institutionalization also increases. It is projected that 40 percent or 12.5 million Americans age 65 plus will live in a nursing home at some time. Among those over age 75, the percentage increases to 60 percent, or three out of five. Nursing home stays are likely to be either quite short or quite long: About half of all individuals who enter a nursing home stay under six months; the others stay for more than three years.

Traditionally, long term care was equated with nursing home assistance or institutional care. Today, long term care services are also provided in a variety of home, community and health care settings. As with institutional care, the probability of needing assistance increases with age: over six million, or 20 percent, of the 65 plus population, and nearly half of the population over age 85, receive long term care assistance in community or home settings.

For those receiving assistance in community settings, care is provided by an array of skilled professionals (e.g., nurses), paraprofessionals (e.g., home health aides), and informal caregivers (e.g., adult children, spouses, other relatives). Informal caregivers, usually female family members, are not reimbursed for their assistance, and they often juggle professional responsibilities with personal obligations. It is believed some 25 percent of all informal caregivers find that caregiving responsibilities affect their work because of excessive telephone use, unscheduled leave, lateness or lower productivity.

Costs of Long Term Care

Aggregate costs for long term care are approximated at over $61.4 billion annually; however, these estimates do not include dollar values for services provided by informal caregivers. Perhaps more telling is the high cost of long term care for the individual consumer. Depending upon geographic location, institutional care for one person ranges from $25,000 to over $60,000 annually. Home-related services can cost up to 60 percent of the rates charged for institutional care.

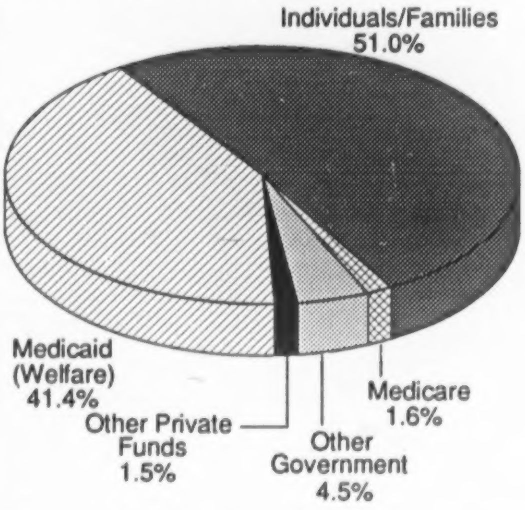
Most Americans, irrespective of age, are uninformed about the financing and potential costs for long term care; they often assume that nursing home and home care are covered by existing health insurance, Medicare, disability insurance or Medigap policies (see Table 1 on page 10). In fact, less than 7 percent of long term care costs are covered by Medicare or private health insurance; remaining fees are paid by private assets or public welfare programs like Medicaid (see Chart 1 on page 10). Further, Medicaid does not assume the cost of long term care until individuals have spent their personal or family assets and have become eligible for welfare payments.

Table 1: Who Covers Long Term Care?

Type of Care	*Medicare*	*Employee/Retiree Medical Plans, HMO, and Medigap Plans*
Nursing Home Care		
Skilled care, first 150 days	COVERS "acute" care only for limited number of days	COVERS "acute" care
Skilled care for 151 days or more	NOT COVERED	NOT COVERED
Intermediate care	NOT COVERED	NOT COVERED
Custodial care	NOT COVERED	NOT COVERED
Home Health Care		
Skilled nursing care	COVERS limited number of "acute" care visits	COVERS "acute" care, sometimes
Home health aide	COVERED only in conjunction with skilled care	NOT COVERED
Adult Day Care	NOT COVERED	NOT COVERED
Professional Care Advisor		
Professional advisor who assists in care planning	NOT COVERED	NOT COVERED

Chart 1

Who Pays for Long Term Care?



Source: Health Care Financing Administration, 1988.

Consumption of and costs for long term care services will expand during the coming decades as a result of changing population demographics and a rapid increase in the older adult population (see Chart 2). In part the result of aging baby boomers, the rapid growth of the most elderly population is augmented by greater longevity. Though the frail and oldest Americans will be seen as the primary consumers of long term care services, other groups at risk include the chronically ill and disabled, such as survivors of serious accidents, mentally retarded individuals, and those with AIDS/HIV infection.

What Role for Employers?

Employer interest in plan sponsorship for long term care has been stimulated by concerns about changing population and work force demographics as well as the economic implications of an older American population. While a benefit like long term care might serve to retain or attract skilled employees, especially in an era of projected work force shortages, other factors make employers cautious about sponsoring a new, untested benefit. Factors contributing to an "employer-go-slow" approach include greater government involvement with corporate human resource policies, in general, and mandated benefits, in particular; escalating health care costs; implications of retiree health care liabilities in light of Financial Standards Accounting Board (FASB) 106;[1] and the lack of national consensus about health care policy.

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[1] Financial Accounting Standards Board statement number 106 (FASB 106) requires accrual accounting for retiree health care, life insurance, and other post-retirement benefits, other than pensions. The standards issued in December 1990 will require companies to record their obligations as a balance sheet liability.

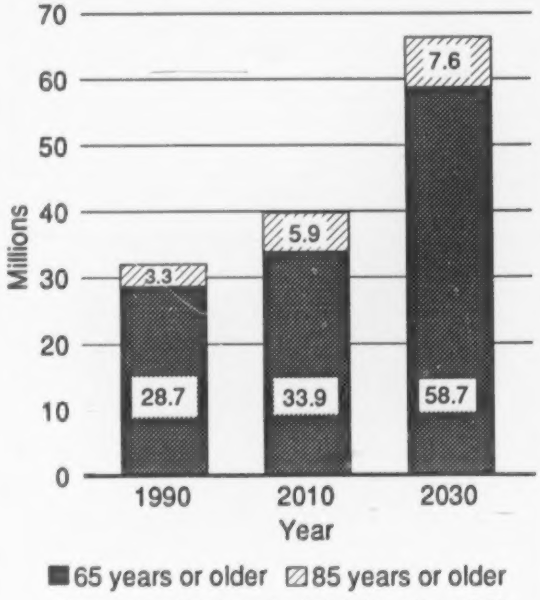
The insurance industry is actively marketing group long term care insurance to potential corporate sponsors as a new product to assist employees and their families, but employers have many questions about long term care products. Long term care lacks the history and definitions associated with traditional health and welfare benefits with which employees are familiar. Long term care is an amalgam of health, life, disability and deferred income benefits. Additionally, employers have questions about the tax status of employer and employee premiums, vehicles to fund plans, and valuation of plan reserves. Lastly, volatility within the insurance industry itself has resulted in concerns about the viability of long term insurance, since plan participants may not require their long term care benefits until many years in the future.

It is in this environment that U.S. business leaders are examining corporate roles in helping employees protect themselves and their families against the risk of long term care liabilities. Specifically, corporations are asking themselves if there is a role for employer-sponsored long term care insurance and, if so, how it should be articulated.

This report reviews employer responses to the rapidly changing long term care marketplace, and discusses the issues, options and challenges to corporate-sponsored long term care. The following section profiles the types of group long term care insurance products that are currently available and provide the framework for corporate-sponsored plans. The report then describes how several pioneering companies have adapted those products to their own companies' environment. Finally, the future of long term care insurance, including barriers and facilitators to corporate sponsorship, is examined.

Chart 2

Growth of the Elderly Population



Source: Social Security Administration, 1988.

Group Long Term Care Insurance: A Rapidly Changing Product

> *"The insurance industry does have a role in long term care. Well-designed and affordable products provide an option to individuals who can afford to protect themselves. The government is then responsible to provide the safety net for those without the necessary resources."*
>
> *—vice president, an insurance company*

For the past 15 years, long term care insurance has been available to individual consumers through insurance agents or various associations. By the end of 1990, nearly two million long term care policies had been written. While the greatest number of policies have been sold to individuals, several industry experts suggest the employer-sponsored group market presents the greatest potential for future growth (see Chart 3). The rapid emergence and evolution of group plan products suggest that employers will have an increasing number of options to evaluate in the coming years.

Emergence of the Employer Group Market

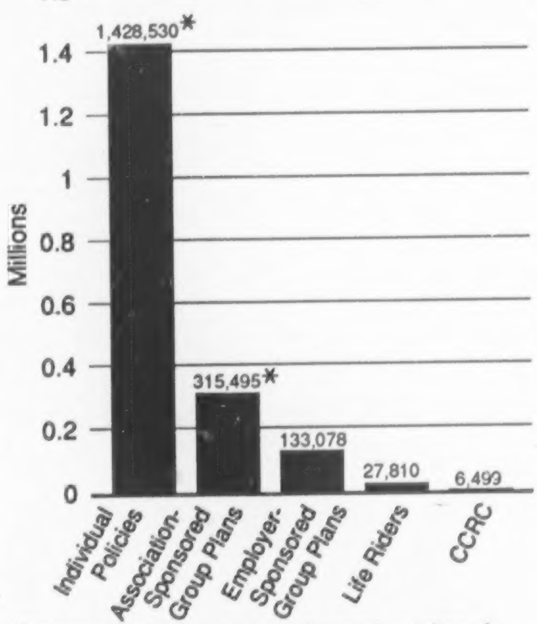
Today, approximately 135 insurance companies offer long term care insurance. Among those companies, only 10 market employer group products, and four or five dominate the employer-sponsored sector.

In the early to mid-1980s, the large group carriers conducted strategic planning studies to identify new markets and products. The aging population and greying work force were recognized as providing new opportunities for group employer insurance. Employer-sponsored long term care was seen as one of several products which could meet the needs of the marketplace. Initially, carriers entered the long term care marketplace not with group policies, but with policies sold through individual agents, Continuing Care Retirement Communities (CCRCs), or trade associations. Since the first corporate-sponsored long term care plan was written in 1987, however, there has been a rapid increase in the number of employers sponsoring plans. Currently, there are approximately 150 corporate-sponsored plans—two-thirds were implemented during 1990 and the first half of 1991 (see Chart 4). Plan sponsors reflect a broad cross section of industries and different sized companies, as shown in Chart 5.

Chart 3

Number of Long Term Care Policies

Sold Through 12/31/90▲



▲These numbers represent the total number of plans sold, not necessarily in effect.

*Estimates of lapses in the individual and group market has been estimated as being 25% to 30%.

Source: Health Insurance Association of America, 1991

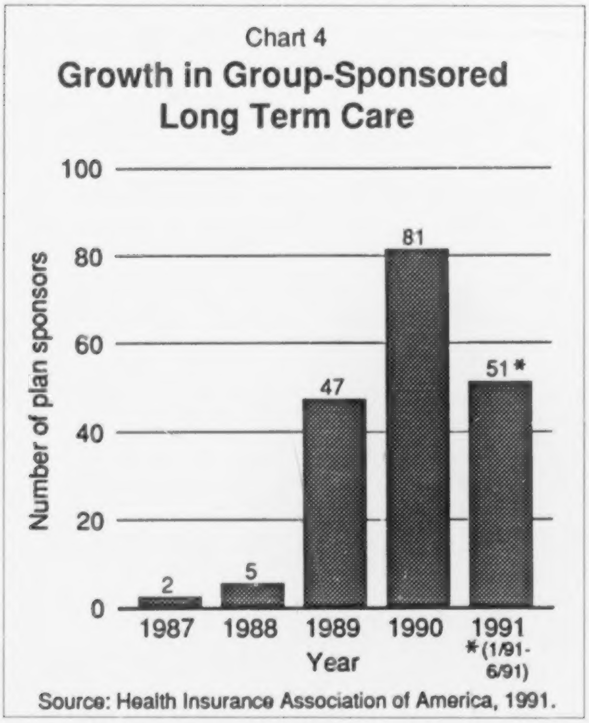


Chart 4
Growth in Group-Sponsored Long Term Care

Source: Health Insurance Association of America, 1991.

In addition to an increasing number of plan sponsors, the past few years have brought significant refinements in plan design features and services covered by long term care insurance. For example, The Travelers refers to several "generations" of plans that have evolved since their first group offering in 1986. Specific enhancements vary by carrier, but most deal with options that expand coverage. Design features, such as waiting periods and exclusion of pre-existing conditions, as well as ancillary services, like nonforfeiture of benefits, are usually a function of the sponsor's plan specifications. Carriers foresee continued refinements in all aspects of their products—from design to services offered and administration—as their experiences in this market increase.

Standard Elements of Group Long Term Care Plans

In contrast to plan sponsors who generally view long term care insurance as a way to help employees protect assets, insurance carriers liken long term care products to health or disability insurance. Experience with health care and disability models strongly influences plan design, underwriting and pricing strategies for the emerging long term care products.

Services covered. Most group plans have expanded coverage beyond traditional institutional and home health care to include adult day care, respite care, and hospice care. Expanding services to include community-based assistance achieves several purposes. It allows individuals the opportunity to stay in their own home or community, a feature desired by most individuals at all ages. It also helps to contain costs since community-based assistance is significantly less costly than institutional care.

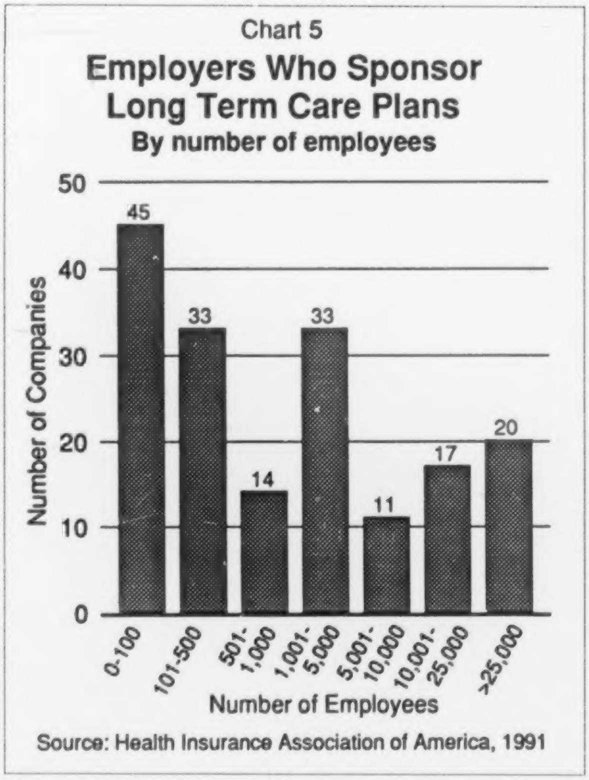


Chart 5
Employers Who Sponsor Long Term Care Plans
By number of employees

Source: Health Insurance Association of America, 1991

One insurer allows participants a "nursing home only option." Participants can elect a comprehensive plan, which includes nursing home and home health services, or a plan with lower premiums that will only cover the costs of nursing home care.

Eligible participants. Since long term care insurance is intended to help active employees plan for their own future, as well as anticipate the possibility of elder care obligations, most plans cover spouses, parents and in-laws as well as active employees. To create a greater participant pool, some carriers require employee enrollment as a prerequisite for spouse and parent eligibility. Further, an employee and spouse may be required to participate prior to enrolling the spouse's parents.

Retirees and their spouses are also likely to be eligible, unless the sponsor is in the process of reevaluating or redesigning post-retirement health benefits plans. "Even if they do not purchase the insurance," one manufacturing executive states, "offering retirees the option has at least two positive outcomes: It gives retirees the option to help protect their personal assets, and can also serve to improve retiree relations, demonstrating company concern about former employees."

Less likely to be covered are eligible employees' grandparents. Restrictions on grandparents are usually the result of medical underwriting requirements, high premium costs, and age limits. Many plans limit enrollment to individuals under age 80. As one carrier explains, "Sending materials and marketing to grandparents is not cost effective. Too few are either eligible or can afford to participate."

Guarantee issue. Medical certification is generally not required for active employees. However, all other groups, including employee spouses, may be required to meet certain underwriting requirements. Depending upon the carrier, eligibility requirements may include completion of a medical questionnaire and/or certification by a physician or health care provider.

Portability and guaranteed renewability. Today, group-sponsored long term care plans are portable. Coverage for plan participants and other covered family members will not terminate merely because the employee leaves the company or retires. Further policies are guaranteed renewable as long as premiums are paid.

Maximum daily benefit levels. The maximum daily benefit is the greatest amount of money a plan participant may receive for each day the person receives benefits. Early plan sponsors were afforded limited options. However, while the lowest daily maximum benefit has remained fairly constant at $50 or $60 per day, carriers have increased the maximum benefit levels. Today, some plan sponsors allow participants the opportunity to purchase a maximum daily benefit of $150 to $200 per day. As a benefits executive at Merck & Co., Inc. points out, "Offering a range of benefit levels provides employees with a choice; this is especially important for plan sponsors who have employees nationwide. Plan participants can select benefit levels appropriate to the long term care costs associated with their local community."

Maximum lifetime benefits. Maximum lifetime benefits refers to a total dollar amount or length of time benefits will be paid by the insurance carrier. With the exception of one major carrier, each carrier in this study limits lifetime benefits to a dollar value equal to four to five years of receiving the maximum daily benefit. One carrier provides participants with the option of purchasing benefits for a period of three years, five years, or a longer period as specified by the plan sponsor.

Fixed premium costs. Like life insurance, a participant's premiums are fixed at the age of enrollment, with the following exceptions:

- *The rate for the entire group changes.* A periodic review of premiums as part of the contract with plan sponsors gives the carrier the option to increase or decrease premium rates for all plan participants. In some cases, the percent increase or decrease may be capped. One carrier says that major changes in premiums are not likely for five years. "We need this [length of] time to evaluate our experiences."
- *The plan participant elects additional coverage.* Several plans provide participants the option to increase their benefit levels on a periodic basis (e.g., every three years) without proving insurability, but all plans allow participants to increase benefit levels at any time with medical certification. Like life insurance, the new premium is generally the original premium plus the rate for the extra benefit based upon the participant's age when the increased coverage is purchased. (Inflation protection, a third reason for premium increases, is discussed later in this section.)

Inclusion of organic syndromes. Plans initially excluded organic syndromes, such as Alzheimer's disease. However, all major carriers now explicitly include organic brain diseases, like senile dementia and Alzheimer's disease.

Activities of Daily Living. Activities of Daily Living (ADLs) refers to the ability to complete certain everyday tasks like eating, bathing and dressing. Introduction of ADL criteria is probably the most significant recent change in the long term care marketplace. While the ADL test has become a standard tool to determine a plan participant's benefit eligibility, carriers differ in defining the number of ADLs and how many ADLs a participant must "fail" prior to being certified eligible for benefits (see Table 2 on pages 15-17).

While the ADL test is appropriate for many situations requiring long term care assistance, it may be inadequate when evaluating for some organic disorders. Consequently, all of the carriers have modified the test. An individual's ability to complete these tasks independently or only with direction by another individual is used when syndromes like senile dementia or Alzheimer's disease are suspected. One carrier also uses a standardized assessment tool along with ADLs when organic illness is suspected.

Reimbursement procedures. How carriers reimburse eligible plan participants is a key distinguishing feature of group plans. Carriers have tended to adopt one of two approaches: Most carriers reimburse an eligible participant up to the maximum daily benefit only upon submission of receipts from a nursing home or from a "qualified" service provider, like a registered home health aide. In contrast, one carrier reimburses eligible plan participants at the maximum benefit level, irrespective of who provides the long term care assistance. In this case, services can be provided by a certified provider or an informal caregiver, such as a neighbor or family member, without submission of receipts.

New Plan Features

New options are constantly being added to the long term care insurance product. The most common

Table 2: Examples of Group Long Term Care Products

	John Hancock	*Metropolitan Life*	*The Aetna*	*The Travelers*
Covered Services	Nursing care (skilled, intermediate, custodial) Home health care Adult day care Respite care	Nursing care (skilled, intermediate, custodial) Home health care Adult day care Care planning visit Respite care	Nursing care (skilled, intermediate, custodial) Home health care Adult day care Respite care Informal care	Nursing care (skilled, intermediate, custodial) Home health care Adult day care Homemaker services Respite care
Eligibles	Active employees Spouses, over age 18 Retirees and retiree spouses Parents and parents-in-law of eligible employees or retirees, under age 80	Active employees and spouses Retirees and spouses Parents and parents-in-law	Active employees and spouses Retirees and spouses Surviving spouses of retirees (maximum of 2 per insured employee or spouse) Parents and parents-in-law	Active employees and spouses Retirees and spouses Parents and parents-in-law
Premiums	Based on age. Guaranteed issue to actives; all other eligible groups subject to underwriting	Based on age.	Based on age. Guaranteed issue to actives and spouses; all others subject to underwriting	Based on age. Initial enrollees and new hires eligible to enroll without evidence of insurability. Others, including part-timers, typically required to provide evidence of insurability by completing a medical questionnaire
Benefit Eligibility & Certification Criteria	Totally dependent for at least 2 of 5 Activities of Daily Living (ADLs): – Bathing and/or dressing – Eating – Transferring from bed to chair – Toileting – Maintaining continence Dependence may be due to physical or cognitive impairment	Totally dependent upon others for at least 3 of 7 ADLs: – Eating – Dressing – Transferring from bed to chair – Toileting – Bathing – Mobility – Continence	Totally dependent upon others for at least 2 of 5 ADLs: – Mobility (walking or wheeling) – Transferring – Dressing – Eating – Toileting	Dependent on others to perform 2 of 6 ADLs: – Dressing – Bathing – Eating – Transferring from bed to chair – Getting around (foot or wheelchair) – Toileting Or, the insured answers 3 or more questions incorrectly on the Mental Status Quotient Test

Table 2: Examples of Group Long Term Care Products (continued)

	John Hancock	*Metropolitan Life*	*The Aetna*	*The Travelers*
Case Management	Case managers are registered nurses (RNs) who certify benefit eligibility. Mandatory case management includes: – Certification of ADL dependence – Review of medical records and consultation with physician – Periodic reassessment and decertification Other non-required services: recommendation of site and level of care; identification of aging and community resources; and information counseling	Care planning advisor is long term care professional not employed by carrier. Voluntary, comprehensive, in-home case management services covered: 1) Care Planning Visit — one time visit offered to all insureds 2) Care Advisory Services — available on an ongoing basis to insureds with comprehensive option	Mandatory case management. Case managers are RNs and master's level social workers with expertise in the in the field of long term care. Responsibilities include: – Information and consultation service – Referral service – Assessment and care planning service – Service coordination – Benefit eligibility certification – Periodic reassessment	Voluntary or mandatory case management available—based on plan design. Case management services: – Eligibility determination – In-home assessment – Personalized care plan – Ongoing monitoring May be a reduction in benefits when mandatory case management services not followed.
Benefits & Coverage Amounts	Actual daily charges for nursing home confinement, home health care services, adult day care, or homemaker services up to the Daily Maximum Benefit (DMB) for the selected benefit level. DMBs range from $60 to $140 per day. Participants select one option at the time of enrollment. The maximum lifetime benefit (MLB) equals 1,825 times nursing home DMB. Following are high and low options for a 5-year MLB: *Nursing home DMB* / *Home health care DMB* / *MLB* $ 60 / $30 / $109,500 $140 / $70 / $255,500	Up to 100% of DMB for nursing home and home care services. Home care coverage equals one-half the coverage of nursing home. Two plan options available: comprehensive (i.e., nursing home, adult day care, etc.) and nursing home only. Maximum lifetime benefit options for 3 yrs. (1,095 x DMB),5 yrs. (1,825 x DMB) or longer. Following are high and low options for a 5-year comprehensive MLB: *DMB* / *MLB* $ 50 for nursing home care / $ 91,250 $ 25 for home care services / $ 45,625 $200 for nursing home care / $365,000 $100 for home care services / $182,500 MLB for nursing home options are identical	100% of DMB for all levels of nursing home care and 50% of DMB for all levels of care service provided by a formal or informal caregiver in eligible home care unit/adult day care facility. DMBs range from $40 to $120 per day. Maximum lifetime benefit options for 3 (1,095 x DMB), 4 (1,460 x DMB), or 5 (1,825 x DMB) years. Following are high and low options for a 5-year MLB: *Nursing home DMB* / *Home health care DMB* / *MLB* $ 40 / $20 / $ 73,000 $120 / $60 / $219,000	Carrier pays benefits for covered services according to following schedule. Amount payable determined by DMB. *Nursing home care* — 100% of reasonable charges up to DMB. *Community-based care* — 100% of reasonable charges up to 50% of DMB. *Respite care* — 100% of reasonable charges up to 20 x DMB per year. MLB equals 1,500 x DMB to 5,000 x DMB. Following are high and low options for a 5-year MLB: *Nursing home DMB* / *Home health care DMB* / *MLB* $ 60 / $30 / $109,500 $100 / $50 / $182,500

Table 2: Examples of Group Long Term Care Products (continued)

	John Hancock	*Metropolitan Life*	*The Aetna*	*The Travelers*
Waiting Period	60 to 90 days after certification. Formal services need not be purchased to satisfy the qualification period.	60 days after admission to nursing home or 30 days after receipt of home care services. All nursing home days count toward nursing home waiting period.	90 days after loss of functional capacity as determined by case management system.	60, 90, or 120 consecutive days of qualifying event. Formal services need not be purchased to satisfy the qualification period.
Premium Waiver	Premiums waived when insured certified as ADL dependent and waiting period satisfied.	Premiums waived after 60 days of service.	Premiums waived when benefit payments commence.	Premiums waived after 60, 90, or 120 consecutive days of confinement , or having a qualifying disability for 60, 90, or 120 days
Premium Collection	**Employees and spouses:** through payroll deduction or direct billing. **Retirees and spouses:** through pension deduction or direct billing. **Parents, parents-in-law, and terminated employees:** through direct billing. (For direct billing, insured elects annual, semi-annual, quarterly or monthly billing.)	**Employees and spouses:** through payroll deduction. **Parents and parents-in-law:** through direct billing. **Retirees:** pension deduction or direct billing.	**Employees and spouses:** through payroll deduction. **Parents and parents-in-law:** through direct billing. **Retirees:** pension deduction or direct billing.	**Employees and spouses:** through payroll deduction. **Parents and parents-in-law:** through direct billing. **Retirees:** pension deduction or direct billing.
Other Features	Inflation protection — Every 3 calendar yrs. from plan's effective date, nursing home care costs will be reviewed using Consumer Price Index or other suitable indicators. Reduced paid up available at additional cost. Paid up coverage equals minimum of 30% of elected DMB beginning after 10 yrs. of premium payment. Return of premium available at additional cost. Death benefit equals total premium paid out to insured to age 65.	Optional inflation protection — Every 3 years, based on changes in LTC costs. Evidence of good health not required. Nonforfeiture options: reduced paid up, cash value, death benefits, extended term.	Plan written with guaranteed benefit upgrade, indexed to inflation. Nonforfeiture value — the actuarial fund balance used to cover the future term insurance cost for the insured's LTC insurance or provide for a reduced paid up benefit for life. Plan may be written with an optional Return of Contribution feature, limited to active employees and their spouses.	Time Earned Insurance (nonforfeiture) is offered in conjunction with a lifetime premium payment provision. Death benefit allows return of premium, less benefits received, to beneficiaries/ estate for all insured up to age 65. Paid up option: after 20 yrs. of premium payments. Both fixed plan and inflation provision options available.

additions are in the area of information and referral services, managed care, inflation protection, and nonforfeiture of benefits.

Information and referral services assist plan participants in finding high quality care. They also help control costs by shortening the search for care and helping participants price different services. In addition, information and referral services assist claimants and their family members identify available services for the eligible beneficiary. These resources may include plan covered services, like nursing homes or qualified adult day care facilities, as well as non-reimbursed services to provide additional assistance, such as family support services, adult companion programs, and information hot lines.

Managed care requirements vary among the carriers (see Table 2). For some, case management is suggested but not a prerequisite to receiving benefits. However, for others it is mandatory to receive specific benefits, or the maximum benefit payable under the plan. One carrier requires a case manager's approval for respite care assistance. Another can reduce the allowable maximum daily benefit by half if a case manager's recommendations are not followed.

Case management includes an assessment by an independent practitioner or insurance carrier representative with expertise in geriatric medicine or long term care. The assessment may involve an evaluation of the person's current living arrangements, physical and mental health status, ability to complete Activities of Daily Living, and availability of formal and informal support systems, such as health care, family and neighbors, and friends. Other financial resources may also be evaluated.

Like other aspects of health care, the cost of long term care is expected to increase greatly during the coming years. Inflation protection options are intended to help participants anticipate future long term care costs, which are likely to be significantly greater than the originally purchased benefit. This can be especially important for younger employees who will probably not require long term care assistance for two to three decades.

Depending upon the carrier and plan design, inflation protection does not generally require medical certification and usually takes two forms:

- *Fixed dollar increase.* With a guaranteed upgrade option, participating individuals are offered the option of increasing their maximum daily benefit by some fixed dollar amount. For example, every three to five years plan participants can increase their maximum daily benefit by $10 or $20.
- *Indexed option.* When electing additional coverage through an indexed inflation protection option, both the individual's premium and maximum daily benefit increase annually. The increase, generally capped at 5 percent, is a fixed percentage tied to the Department of Labor's Consumer Price Index or similar inflation barometer.

Nonforfeiture options, also called paid up option and time earned benefits, are an alternative to premiums that continue for the participant's lifetime. With time earned benefits, plan participants maintain coverage even if they elect to stop paying premiums.

There are three approaches to nonforfeiture options:

- In some plans, participants who stop paying premiums after 10 years have a guaranteed benefit equal to 30 percent of their maximum daily benefit. The guaranteed benefit increases for each year the participant pays premiums beyond 10 years.
- Another approach is based upon an "extended term insurance" model. Plan participants who cease paying premiums have an actuarially determined fund balance that is used to pay premiums for a period of time determined by the carrier.
- A third approach is a prepayment model. After 20 years, for example, insured individuals who elect this option have a paid up policy. Like a mortgage, no further premium payments are required.

Return of contribution. A return of contribution feature, also called a death benefit, is often seen as a tool to attract participation by younger employees. It is generally restricted to active employees and their spouses.

With a return of contribution feature, the estate or named beneficiary receives the cash value of the participant's premiums upon death. The main commonality among the different carriers is the gradual reduction of the cash value of the premiums usually beginning at age 65. Significant differences exist among the carriers; for example, one carrier's death benefit equals the total premiums paid minus any benefits received. Another carrier eliminates death benefits if the participant was deemed eligible for a benefit waiver.

The decision to offer a return of contribution option depends upon the perception of long term care insurance. One insurance executive explains, "If long term care is perceived like homeowners or auto insurance, a return of premium option should not be offered; however, if it is perceived as a way to help develop an estate, then a death benefit option seems more appropriate."

The rapid emergence of the long term care market offers both distinct and subtle differences for employers to evaluate. Because the employer group market will continue to evolve, companies evaluating their existing plans or considering plan sponsorship need to compare carefully the distinguishing features and options among different long term care insurance products.

Long Term Care in Employee Benefit Plans

> *"The government isn't doing real well with health care, in general, let alone long term care. We thought something needed to be done."*
> *—benefits manager, a manufacturing company*

Employers and insurance carriers agree: Interest in and sponsorship of corporate-sponsored group long term care insurance will continue to grow steadily over the next several years. Despite uncertainties and caution, many companies say they are investigating the feasibility of offering a long term care insurance option to employees. A recent survey projects an increase in plan sponsorship from 8 percent in 1990 to 68 percent by the year 2000.[2]

The most cautious companies believe growth of the employer market will occur slowly. Their interest in initiating a long term care plan is tempered by more immediate concerns such as managing existing health care benefit costs for active employees, implications of FASB 106 for existing retiree health plans, and the fear of creating employee expectations of a new entitlement program. An executive at a major pharmaceutical company expressed longer term concerns about the possibility of government-mandated long term care benefits or legislation that might penalize progressive employers—like the repealed Medicare Catastrophic bill that would have required employers to return part of a premium to retirees. Another *Fortune*-100 company expressed concern about whether a plan with benefits meaningful to today's beneficiaries would retain value for beneficiaries who may not require the benefit for many years.

Reasons for Sponsoring a Plan

Despite the uncertainties, benefits managers cite many and varied reasons for considering plan sponsorship. Long term care is a natural complement to existing benefit packages; it helps employers maintain their role as industry leaders in employee benefits; it can assist employees in protecting their retirement savings; and it is one piece of an integrated corporate work-family initiative.

A complement to existing benefits. In this study long term care was described by both carriers and companies as a benefit that protects against health-related risks not covered by existing acute care health benefits and disability insurance. In several instances, this lack of coverage was identified during employee focus groups and management meetings where existing benefits were reviewed and strategies to help manage health care costs were discussed.

Several carriers and corporations, each of whom have employee-pay-all plans, regard long term care as a high-visibility, low-cost employee benefit. "It is a no-cost benefit with many positive outcomes, like enhancing employee morale and giving employees more choices," according to one senior manager at American Express.

Plan sponsorship also helps to protect management's investment in employee benefits. Executives point out that employers spend considerable time and money to design, implement and maintain employee benefit programs that can be jeopardized if an employee is hit with heavy long term care responsibilities. One senior manager explains, "When employees lose their pensions and personal savings due to long term care, we lose our investment in helping them prepare for their future."

Leadership in employee benefits. Both American Express and First Interstate BanCorp indicate that their companies' desire to be viewed as "cutting-edge" employers contributed to their decision to sponsor a long term care benefit. "We want individuals to want to come to American Express," states one benefits manager. "We work hard to maintain our visibility as an industry leader. Our benefits planning department is charged with the responsibility of looking at and evaluating the newest products and services."

Protect retirement assets. Offering employees a long term care insurance option is seen as a way to help employees assume responsibility for their personal

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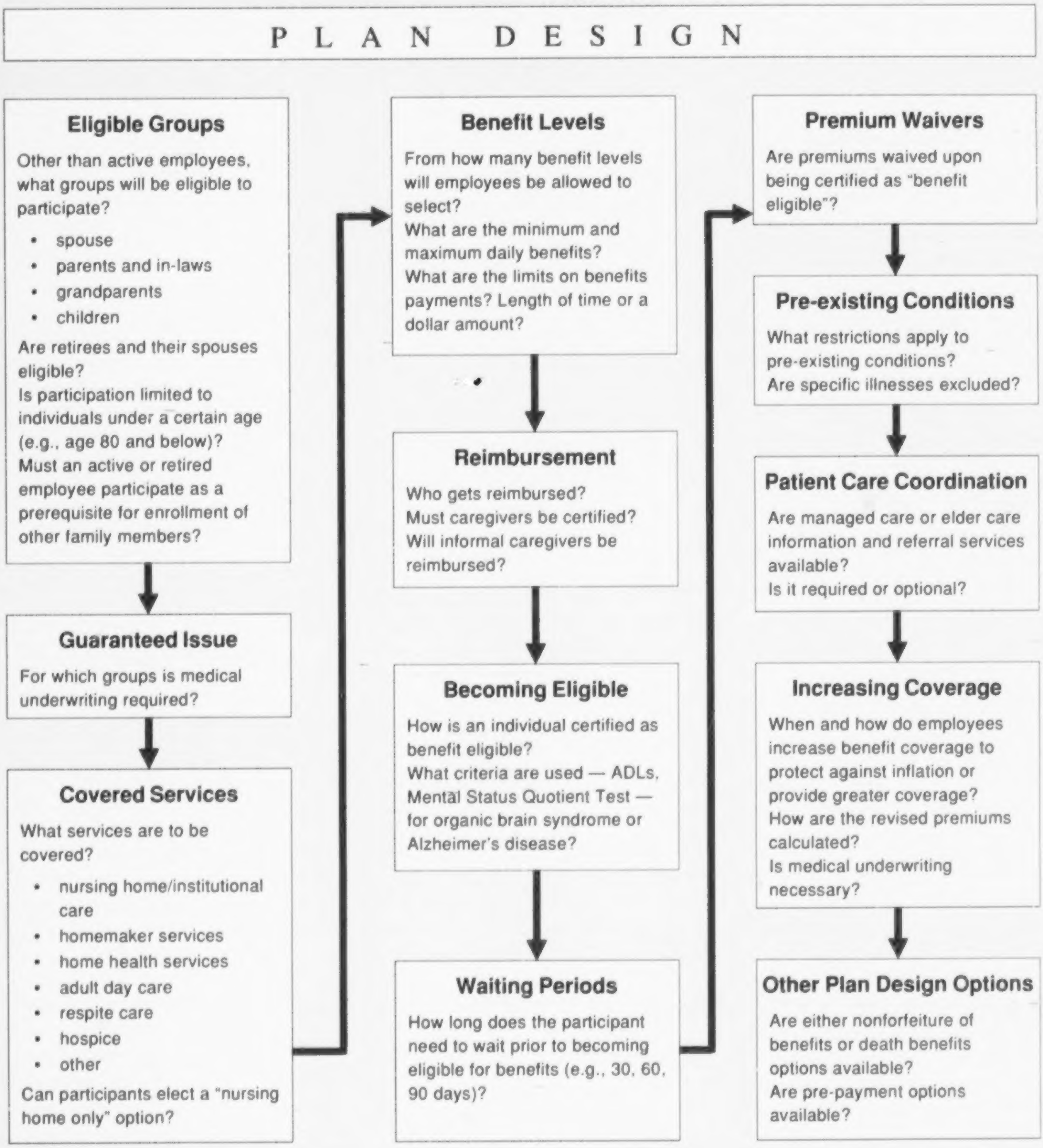
[2] International Foundation of Employee Benefits, "Nontraditional Benefits for the Workforce of 2000," August 1990.

Table 3: Designing and Administering a Long Term Care Benefit Plan
A Framework for Decision-Making



PLAN DESIGN

Eligible Groups

Other than active employees, what groups will be eligible to participate?

- spouse
- parents and in-laws
- grandparents
- children

Are retirees and their spouses eligible?
Is participation limited to individuals under a certain age (e.g., age 80 and below)?
Must an active or retired employee participate as a prerequisite for enrollment of other family members?

Guaranteed Issue

For which groups is medical underwriting required?

Covered Services

What services are to be covered?

- nursing home/institutional care
- homemaker services
- home health services
- adult day care
- respite care
- hospice
- other

Can participants elect a "nursing home only" option?

Benefit Levels

From how many benefit levels will employees be allowed to select?
What are the minimum and maximum daily benefits?
What are the limits on benefits payments? Length of time or a dollar amount?

Reimbursement

Who gets reimbursed?
Must caregivers be certified?
Will informal caregivers be reimbursed?

Becoming Eligible

How is an individual certified as benefit eligible?
What criteria are used — ADLs, Mental Status Quotient Test — for organic brain syndrome or Alzheimer's disease?

Waiting Periods

How long does the participant need to wait prior to becoming eligible for benefits (e.g., 30, 60, 90 days)?

Premium Waivers

Are premiums waived upon being certified as "benefit eligible"?

Pre-existing Conditions

What restrictions apply to pre-existing conditions?
Are specific illnesses excluded?

Patient Care Coordination

Are managed care or elder care information and referral services available?
Is it required or optional?

Increasing Coverage

When and how do employees increase benefit coverage to protect against inflation or provide greater coverage?
How are the revised premiums calculated?
Is medical underwriting necessary?

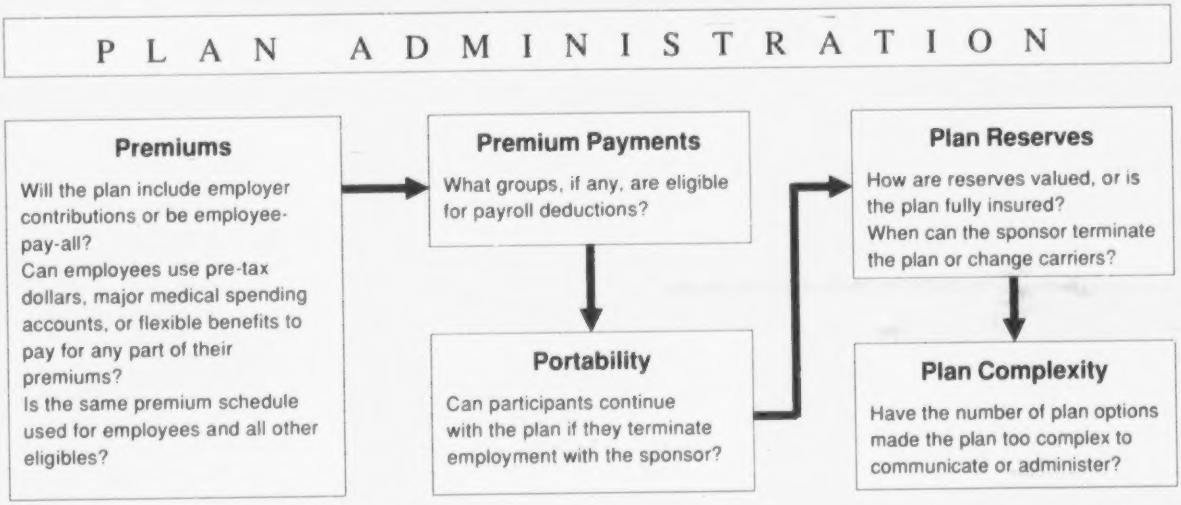
Other Plan Design Options

Are either nonforfeiture of benefits or death benefits options available?
Are pre-payment options available?

financial planning and shift some responsibility for employee benefits from the employer to the employee. Sponsors and non-sponsors agree, long term care liabilities can eliminate most employees' pensions and personal estates, in some cases leaving the surviving spouses in financial distress. Long term care insurance in these situations is a form of asset protection.

For example, many retirees find that their annual retirement income cannot support $20,000 to $60,000 a year for institutional long term care services. Some stud-

Table 3: Designing and Administering a Long Term Care Benefit Plan
A Framework for Decision-Making (continued)



PLAN ADMINISTRATION

Premiums

Will the plan include employer contributions or be employee-pay-all?
Can employees use pre-tax dollars, major medical spending accounts, or flexible benefits to pay for any part of their premiums?
Is the same premium schedule used for employees and all other eligibles?

Premium Payments

What groups, if any, are eligible for payroll deductions?

Portability

Can participants continue with the plan if they terminate employment with the sponsor?

Plan Reserves

How are reserves valued, or is the plan fully insured?
When can the sponsor terminate the plan or change carriers?

Plan Complexity

Have the number of plan options made the plan too complex to communicate or administer?

ies suggest that over 55 percent of all individuals "spin down" personal assets, becoming welfare and Medicaid eligible within six months of entering a nursing home. Within one year, the percentage increases to 74, and between one to two years 95 percent of all nursing home residents have depleted personal resources.[3]

Assist employees with elder care. Long term care insurance is identified implicitly or explicitly as a need in corporate studies looking at elder care issues. At American Express Travel Related Services, where the work force is primarily women, employee focus groups indicated that care for a dependent elderly relative by a working caregiver, though not an immediate concern, is a potential threat to productivity. American Express managers inferred long term care insurance was one possible benefit that could help employees stay in the work force and still fulfill their elder care responsibilities.

At IBM, a strategic planning study identified long term care as one piece of their corporation's integrated work-family initiative. "While information and referral services are important," noted one senior manager, "we still needed a benefit that might help employees pay for their immediate and future elder care responsibilities."

Designing a Long Term Care Benefit

Carriers and companies suggest corporate-sponsored long term care requires significant preparation time because it involves considerations different from other benefits. Companies that have successfully launched long term care plans have undergone three sets of activities: self-education about long term care; selecting a vendor; and tailoring a long term care product to the employer's demographics and benefit package. (See Table 3 for questions that can help guide the design of a long term care plan.)

Understanding the differences between long term care and other benefits. As a corporate-sponsored benefit, long term care differs from most other traditional members of the benefit package. Depending upon the final plan design, long term care insurance can provide assistance for a variety of situations. As a health benefit, long term care pays for services not covered by traditional acute care policies. Like disability policies, it provides income when one can no longer work. Since most consumers of long term care receive benefits during their retirement, it can be likened to some deferred income benefits.

Unlike medical insurance, benefits that cover active employees and their immediate family, long term care plans can cover populations not traditionally targeted by employee benefits. Plans can include parents, inlaws and grandparents.

Selecting a vendor. Early plan sponsors, for example, Procter & Gamble and American Express, had only a few insurance products to evaluate. Today, the marketplace is changing rapidly, and vendor selection requires a careful look at subtle differences among products.

For some companies selecting a vendor also includes choosing a carrier whose corporate culture and approach to benefit design and administration complements the plan sponsor. Relevant factors range from developing a communication strategy and enrollment process consonant with the plan sponsor's culture to ensuring that the participants eligible for benefits receive them easily. As a benefits manager from Motorola points out, "We are concerned that the carrier be neither too stringent nor too liberal in the payment of benefits to eligible plan participants."

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[3] Brian O. Burwell, E. Kathleen Adams and Mark Meiners, "Spend-Down of Assets before Medicaid Eligibility among Nursing Home Recipients in Michigan," *Medical Care*, April 1990, pp. 349-362.

Because of the purpose and nature of the benefit, several companies suggest that choosing a long term care carrier also implies a long term carrier-sponsor relationship, further complicating the selection process. One sponsor says, "Our plan is designed for the long haul; it's for active employees and their spouses who are not likely to utilize the benefits for 20 to 30 years." During this period, the premiums will accrue into a tremendous build-up of reserves.

While all sponsors do review the plan administration and carrier performance, not all companies have negotiated the specifics by which the carrier will value reserves if the sponsor decides to change carriers. One plan sponsor is now finding this to be a potential stumbling block; three other companies who have or are in the process of implementing plans emphasize the importance of "good faith" on the part of both parties, and some agreement—at least in principle—as to parameters by which the reserves will be valued. One sponsor reports, "We have built in a number of provisions, but it was the hardest and lengthiest part of the entire [design and implementation] process."

Most plan sponsors engage outside brokers or consultants to assist in identifying potential carriers, designing, developing requests for proposals (RFPs), producing employee communications, reviewing proposals, and assisting in vendor selection. Consultants who are truly knowledgeable about long term care are described by several plan sponsors as a "tremendous asset; they move the process." However, since group long term care is a new benefit and is significantly different from other health-related benefits, not all benefit consultants can add value to the decision-making process.

Customizing a long term care product. The design for a company's long term care plan is shaped by work force demographics, objectives for plan sponsorship, and options available when the carrier-sponsor contract is signed.

Several companies in this study describe trade-offs in the design process. For one company considering plan sponsorship, "the greatest concern is designing a plan that will not become antiquated." Companies are also concerned that too many options make premiums too costly, and the plan too difficult to communicate or too unwieldy to administrate. One plan sponsor realized his company's "simple" plan with three benefit levels and an inflation protection option was really six plans, and under certain conditions—like phasing out a lower level benefit and introducing a new higher level benefit—could become 12 or 15 plans in under 10 years.

Though liability does not appear to be a major concern, one sponsor raised the question of whether plan sponsorship in any way might imply a formal endorsement of the plan, leaving the employer open to a lawsuit. "Today, malpractice is big business," notes one sponsor. "While the chance is slight, I sometimes wonder if we might find ourselves considered liable for something we never could have anticipated."

Differences and Similarities in Corporate Plans

Among plans studied for this report, eligible participants are defined as employees and their spouses, parents, and in-laws. Retirees and their spouses are also eligible, with the exception of the CBS plan in which retiree health benefits plans are being revised (see Table 4).

Long term care services covered by each plan include nursing home, home health, and adult day care. The American Express plan also includes carrier-provided elder care referral services, while respite care is a plan feature of the IBM and CBS plans.

With the exception of American Express and First Interstate BanCorp, where criteria for benefit eligibility is certification by a health care provider or copies of bills submitted by a nursing home facility, all other plans use ADLs to determine benefit eligibility.

Enrollments range from a low of 2 percent to a high of 15 percent. All of the plans, except for IBM, are employee-pay-all. (See pages 32-33 for a description of IBM's approach to employer contributions.)

The number of benefit levels allowed for by each of the plans varies among sponsors. IBM and CBS offer three benefit levels while American Express and First Interstate BanCorp offer two options. Procter & Gamble offers a single plan. The maximum daily benefit applies to nursing home care; benefits for home health and adult day care are 50 percent of the nursing home benefit. The lifetime maximum benefit for each plan is a dollar amount; it ranges from 1,200 to 1,825 times the maximum daily benefit.

The waiting period for benefit eligibility also differs among plan sponsors. Four plans—Procter & Gamble, IBM, American Express, and First Interstate BanCorp—have a waiting period of 90 or 120 days from either being certified eligible or entry into a nursing home. In contrast, the waiting period for the CBS plan is defined by the types of long term care services provided.

There is considerable variability as to the period of time which defines a pre-existing condition and the impact of a pre-existing condition upon receiving benefits. The time limit on pre-existing conditions or medical treatment received by a plan member ranges from three months to one year prior to enrolling in a long term care plan. In some plans, treatment for a pre-existing condition during the plans' waiting period can preclude any future receipt of benefits. Premium waivers range from

Table 4: Examples of Employer-Sponsored Long Term Care Plans

	American Express	Procter & Gamble	First Interstate Bank	IBM	CBS
Year Plan Initiated	1987	1988	1989	1990	1991
No. of Eligible Employees	30,000	48,000	32,500	200,000	6,000
Participation Rates	7%.[1] Average age: 35 yrs.	15%. Average age for employees and spouses: 40 yrs.	2%.[1] Average age: 37 yrs.	8%. Average employee age: 44 yrs.	NA[2]
Eligible Groups	– Employees, retirees and spouses – Employee parents and in-laws Employee/spousal enrollment not required for parental/in-law coverage. Medical underwriting required for retirees, parents and in-laws.	– Employees, retirees and spouses – Employee parents and in-laws Employee enrollment required for spousal eligibility. Parent eligibility contingent upon employee enrollment; employee's spouse must enroll for in-law eligibility. All eligibles must demonstrate good health.	– Employees, retirees and spouses – Employee parents and in-laws – Retirees and retiree spouses	– Employees, retirees and spouses – Employee parents and in-laws Employees: guarantee issue for all benefit levels during enrollment. Spouses guarantee issue for $50 or $100 benefit. Spouses desiring $150 benefit and all other groups must complete medical questionnaire.	– Employees and spouses – Employee parents and in-laws – Employee grandparents
Employer/ Employee Contributions	Employee-pay-all	Employee-pay-all	Employee-pay-all	Limited employer contribution through IBM Personal Health Assistance Plans	Employee-pay-all

[1] Participation rates represent total number of plan participants (e.g., employees, spouses, parents, retirees) in relation to total number of active eligibles.
[2] Enrollment data were being compiled and therefore not available.

Table 4: Examples of Employer-Sponsored Long Term Care Plans (continued)

	American Express	*Procter & Gamble*	*First Interstate Bank*	*IBM*	*CBS*
Covered Services	– Nursing home – Home health care – Adult day care –Elder care referral services	– Nursing home – Home care unit – Adult day care – Respite care	– Nursing home – Home health care – Adult day care – Elder care referral services	– Nursing home – Home health care – Adult day care – Respite care	– Nursing home – Home health care – Adult day care – Respite care
Daily Benefit Options:					
Nursing Care	$50/day $100/day	$60/day	$50/day $100/day	$50/day $100/day $150/day	$60/day $90/day $120/day
Home Health Care	25/day 50/day	30/day	25/day 50/day	25/day 50/day 75/day	30/day 45/day 60/day
Adult Day Care	25/day 50/day	30/day	25/day 50/day	25/day 50/day 75/day	30/day 45/day 60/day
Respite Care	NA NA	30/day	NA NA	50% of Daily Maximum Benefit up to 20 x DMB	14 days per year at purchased DMB
Lifetime Maximum	$75,000 $150,000	$109,500	$75,000 $150,000	$95,000 $185,000 $275,000	$120,000 $180,000 $240,000
Eligibility Criteria	Written recommendation and considered medically necessary by licensed physician.	Two of five Activities of Daily Living (ADLs).	Verification in writing by physician or copies of bills from long term care facility.	Two of five ADLs.	Two of five ADLs and medical certification for organic diseases.
Reimbursement Criteria	Benefits not offset by any other plan; covered claimants receive actual daily benefit irrespective of actual cost incurred.	Reimbursement at Daily Maximum Benefit (DMB) level, irrespective of the number of services received daily.	Reimbursement to the DMB level as provided by a licensed provider.	Payment of actual charges up to the selected DMB for services provided by licensed vendor.	Reimbursed to DMB for services provided by licensed vendor. *Exception:* respite care requiring 6 months assistance by an informal caregiver.

Table 4: Examples of Employer-Sponsored Long Term Care Plans (continued)

	American Express	*Procter & Gamble*	*First Interstate Bank*	*IBM*	*CBS*
Premium Waiver	120 days covered services in a nursing home; home health and adult day care.	90 days from certification; 90 days from certified loss of functional capacity.	120 days of nursing home, home health care, and/or adult day care. 90 days of Qualifying Services.[3]	During benefit period.	90 times the DMB amount.
Waiting Periods	90 days of qualifying services.	Medical condition diagnosed or treated 90 days before effective date of coverage.	Medical care for an injury within a six-month period of effective date of coverage.	Upon certification, 120 days of qualified expenses.	60 days of nursing home care. 15 days of home health and adult day care.
Pre-existing Conditions	Treatment for illness within 6 months of effective date constitutes a pre-existing condition. Pre-existing condition resulting in home health or adult day care will preclude reimbursement within 6 months of coverage and does not count toward 90-day qualifying period.	Treatment of pre-existing condition within 6 months of effective date is not covered.	Treatment for pre-existing condition within 6 months can exclude any future eligibility. Treatment for pre-existing condition after 6 months of effective date is covered.	Treatment or medical advice in 6 months preceding effective coverage date defines pre-existing condition. Coverage is delayed by 6 months from the effective date for a pre-existing condition.	Treatment or advice within 12-month period prior to coverage determines pre-existing condition. Treatment of pre-existing condition after 12 months is covered.
Other Features	With medical certification, covered individual can increase coverage.	Return of Contribution for all participants. Nonforfeiture of benefit.	Nonforfeiture of benefit. With medical certification, participants can increase coverage.	Inflation adjustment option. Nonforfeiture of benefit.	Inflation protection option for parents, in-laws, and grandparents.

[3] Qualifying services include any combination of nursing care, home health or adult day care. Services do not have to occur on consecutive days.

80 to 120 days. Salient characteristics of each plan are highlighted in Table 4. Because of rapid changes within the industry, some early plan sponsors are reevaluating benefit levels, types of benefits provided, premium costs, and administration.

The Cost of Premiums

"Premiums today are something like a crap shoot," says one benefits executive. "The insurance industry is pricing out a product for which there is no actual history." Employer concern about correctly pricing insurance premiums is echoed by carriers. If the initial premiums are too low, leading to significant increases in the near future, there is likely to be an adverse impact upon participation rates and employee relations. However, if the initial premiums are too high, the prohibitive costs will depress participation among eligible employees and their families. Employees will perceive an imbalance between premium cost and potential long term value. Since employee participation rates for all plans are low, hovering in the 8 to 10 percent range, correctly pricing the premium is critical to a successful program.

Employer-sponsored plans, in contrast to long term policies marketed through individual insurance agents or trade associations, generally offer better value. Employer group plans usually offer more features and greater assurance of coverage. Employers who do not point out these differences when educating and promoting the plan to employees appear to be missing an excellent education and marketing opportunity. Coverage of long term care in the popular press raises many employee questions and concerns about plan comparability. Procter & Gamble's high participation rate is partially attributed to enrollment materials that contained explicit cost and coverage comparisons between the company's long term care plan and three other plans.

A number of factors affect the premium cost. In general, the older the participant, the greater the premium. Larger employer groups tend to have more potential participants, which lowers costs. Premiums also vary as a function of the benefit levels and number of options—such as return of contribution or inflation adjustment—allowed under the plan. For some carriers, the employee/spouse premium schedule differs from rates for an employee's parents and in-laws and for retirees and their spouses. As one might expect, the more options, the greater the cost. However, not all design features and options have equal impact upon premiums. Because of this variability, comparing plan premiums is difficult (see box on page 27).

Administering a Long Term Care Plan

Rolling-out and developing administrative procedures for a long term care benefit require as much attention as the selection of a vendor and plan design.

Introducing long term care. Employers agree that introducing an employer-sponsored long term care benefit requires significant planning. For example, one *Fortune*-100 company's experience suggests that their high penetration levels stem primarily from an effective first enrollment campaign. When employees were offered a second open enrollment period, the participation rate increased by only 2 percent. "If eligible employees do not elect coverage during that first enrollment, you've lost them. Participation at a later time is unlikely," states the benefits manager. Further, this company found that when a parent, spouse or in-law was denied coverage there was a reasonable chance the eligible employee would also drop coverage, apparently for emotional rather than financial reasons.

It is also important to select a time when employees are not grappling with other significant changes in benefit design or increased premiums. One company's low participation rates were attributed to the introduction of a long term care option concurrent with a major redesign in the health care benefits that introduced managed care and increased employee premiums. Focus groups held after the implementation revealed that employees did not fully understand the benefit and distrust of management's intent for plan sponsorship. Employees also expressed concern about affordability of another benefit given the increases in health care premiums.

At CBS, since management had decided to reevaluate existing retiree health benefit plans, the company postponed offering its long term care plan to retirees. CBS' goal is to ensure that retirees understand the new health plan before introducing the long term care option.

Long term care in a flexible benefit environment. At Procter & Gamble, managers attributed the ease of enrollment and administration to employee familiarity with a flexible benefits plan, which enabled them to make informed choices about their benefits. "By allowing employees to make some additional choices," explains a senior manager from Merck & Co., Inc., "long term care turned out to be icing on the cake." BankAmerica is adopting a similar approach; they will be rolling out their long term care benefit as part of their transition to a flexible benefits plan and an option for employees who want a full range of coverage. BankAmerica views long term care insurance as a natural fit with the full range of benefits included in their cafeteria plan.

Maximizing Enrollment—Educating Employees

The decision to purchase long term care insurance is based heavily upon the employee's understanding of the benefit or some personal experiences of the value of long term care. Both IBM and Procter & Gamble believe that their comprehensive education campaigns contributed strongly to high enrollment rates. For IBM,

Variability in Premiums for Long Term Care

Premiums are a function of basic design features, such as waiting periods, as well as plan options like inflation protection or return of contribution. Each of these options has a differential impact upon a base premium. Further, the range of premiums for long term care insurance increases rapidly as a function of the participant's age and the maximum benefit level provided by the plan.

For example, Table A shows how a 30 year old might pay between $65 and $85 per year for a $50-a-day benefit; the range between high and low coverage premiums is only $20 per year. In contrast, a 45-year-old employee might find the annual premium ranging $340 to $470 per year, with a $130 spread between minimum and maximum coverage.

Table B points out the impact of two different plan options—return of contribution or time earned benefit—upon a fixed $100-a-day benefit for three different aged participants. It appears the return of contribution feature is generally a less costly option than time earned benefits. Further, the impact of time earned benefits is greatest for younger employees. In other words, a younger plan participant pays more for this latter benefit than does a middle aged or older plan participant.

Table A: Range of Monthly Premiums for Different Plan Sponsors[1]

Enrollment Age	*$50-a-day Benefit*	*$100-a-day Benefit*	*$150-a-day Benefit*
30	$65–85	$105–170	$145–260
45	115–170	230–315	340–470
60	370–525	715–1,050	1,060–1,520

Table B: Impact of Return of Contribution and Time Earned Options Upon Monthly Premiums

		Return of Contribution		*Time Earned Benefits*	
Enrollment Age	*$100-a-day Benefit[2]*	*Premium*	*Percentage Increase*	*Premium*	*Percentage Increase*
30	$109	$123	12.4%	$206	68.0%
45	272	311	14.4	470	51.2
60	727	791	8.8	799	9.9

[1] These ranges were calculated as averages of several different employer plans. There was no attempt to control for any design features or plan options.

[2] These figures do not represent one specific plan. They are caluculated as a percent increase on several comparable "plain vanilla" plans without special options.

the purpose of their campaign was explicitly bifocal: educating employees about why they should be concerned about long term care and showing how the IBM plan could help employees protect themselves and their families against the costs of long term care.

Corporate culture determines the level of the involvement in the development and implementation of the employee education campaign. At American Express, there was extensive corporate involvement in the design and distribution of employee education and marketing materials, because, according to the manager of employee benefits planning, "It is our culture to take an active role in the design and communication of employee benefit plans." At another company, with the approval and input of the benefits planning and communications staff, the carrier assumed responsibility for developing employee education materials.

Carriers and employers concur: extensive employee education is key to successful enrollment. Education and marketing materials can take many forms and include the following:

- *Booklets and targeted written materials.* Separate booklets discussing long term care can be used to complement standardized Summary Plan Descriptions (SPD). These booklets discuss what the benefit is, and why long term care insurance might be a valuable benefit to different eligible groups.
- *Videotapes.* Several companies, like IBM, have developed company-specific videotapes for employee use on their home videocassette recorders and to share with parents, in-laws, and other eligible family members.
- *Group discussions.* Most employers hold group discussions with eligible employees. At these meetings the purposes of the benefit are described. The relationship of long term care to other employee benefits and how long term care insurance fits into an employee's personal benefit plans are also explained. Discussion group leaders usually include representatives of the

benefits department and the carrier's long term care division.

- *Toll-free "800" telephone number.* Most carriers provide employees and other potential plan participants with a toll-free phone number to reach trained carrier representatives who are able to answer specific questions about the plan design, eligibility, benefit levels and plan features.
- *Personalized letters from the CEO or senior human resource manager.* At CBS, personalized letters describing the availability of this new benefit were an important method of educating employees and their families—including parents and in-laws—about long term care. Some companies send the letter to an employee's home; others mail it to an office address.
- *Kiosks and audiovisual monitors.* Several companies utilize kiosks and internal television systems to publicize their long term care plans. These visuals keep employees aware of the benefit and remind employees where they can get further information.

The corporate "champion." Often an internal champion is responsible for stimulating senior management's interest and support and focusing attention on long term care as an employee benefit. In some cases it is a senior manager whose commitment stems from personal experience with a family member. At Air Products and Chemicals, Inc., the champion is a senior manager who had personal experience with a family member requiring long term care assistance. At Motorola, the champion's interest in corporate-sponsored long term care stems from her previous training in aging and social work together with her current responsibilities as a benefits manager. For this manager, it seems "logical that our understanding of benefits could make a difference. We could help employees plan for their future benefits needs."

Servicing the client: claims and employee lapses. Because most of the programs are relatively new, data on claims experience and lapses are limited. In fact, one of the oldest plans had only two claims in 1990. Another early plan sponsor reports that claims are, "less than a handful since we implemented the plan." The manager goes on to state, "We implemented our plan to help employees over the long haul; we really don't want a lot of early claims. This lag time also helps the carriers who need to refine and make sure their systems—like reviewing claims, assessing eligibility and paying benefits—are in place. So, in 15 or 20 years, when the claims really begin to come in, everything is fine-tuned."

Lapses are not reported as a major issue by either sponsors or carriers. Once employees enroll, they generally remain plan participants, especially when premiums are paid through a payroll deduction system. The only exception, reports one company, "were a couple of employees who misunderstood the benefit. They dropped out because they thought it was long term disability insurance."

Lapse data for individuals like former employees, divorced spouses, parents, in-laws and other dependents billed directly by the carrier are less clear since the employer is not directly involved and does not collect data. Two carriers express concern about lapses and report that they are beginning to look at the data among those individuals who are billed directly. One carrier states, "Our sense is that economic hardship is a primary reason for people dropping coverage. If you've been laid off, long term care insurance may seem like a luxury item." Other reasons suggested by industry experts are death of a plan participant or the opportunity to join a new plan with lower premiums or a broader range of benefits.

While there are significant differences in plan design—suggesting that no one plan meets all sponsors' needs—each of the interviewed employers believes that implementing a long term care benefit was a correct business decision and is meeting a definite employee need. Most are reasonably certain their plans will continue to be refined during the coming years as a result of their evolving corporate environments, the product itself, and government involvement in the benefits and health care arena.

The Future of Corporate Long Term Care

> *"We are proud of our long term care plan...and we believe it is of value to our employees. Only a few companies have made the same kind of commitment. While we don't mind being out there, it would be nice to have some others in this boat with us."*
> *—senior vice president, a Fortune-100 company*

Despite uncertainties in the legislative and underwriting environments, many benefit executives believe employer-sponsored plans can play a significant role in meeting the needs of an aging population and an increasingly diverse work force which includes older workers. "If what has happened during the '80s, and so far in the '90s, is indicative," points out a senior benefit executive, "we will likely spend in excess of 20 percent of our lives in retirement. We are going to live longer and a great many of us will require some kind of long term care."

Long term care is also compatible with current benefit planning and administration trends, which are shifting responsibility for personal benefit planning from the employer to the employee. "We can no longer maintain our old 'parental' approach to benefits," points out one benefits executive, "It has to be a partnership between employee and employer." The same thinking is echoed by another benefit executive, "To help employees assume responsibility for their future, we need to be responsible for providing them with different benefit options and the information that gives them the ability to make appropriate choices."

For many benefits executives, adding employer-sponsored long term care to a traditional employee benefit package makes sense. One potential sponsor observes, "Long term care is a throwback to my early days in benefits. In those days we developed benefits to help protect employees against catastrophes." Even non-sponsors in this study were nearly unanimous in their view of long term care insurance as a benefit that cannot be ignored indefinitely. "It is going to be part of our strategic benefit plan," reports one company considering plan sponsorship.

Long term care complements traditional benefits in two ways: (1) It is insurance to pay for the cost of long term care services, be they in an institutional or community setting; and (2) long term care also helps individuals protect their pension and other assets which would be depleted without this insurance. Seen in a life-cycle context, long term care becomes a protective umbrella for traditional benefits across a lifetime. Chart 6 on page 30 provides a conceptual framework for understanding the relative importance of long term care insurance across an employee's worklife.

The future of long term care, however, must be viewed in relation to social, medical and government policy. "We don't have it packaged well," explains one benefits executive. "It is not just long term care, it's the whole medical and retirement thing." This sentiment is reinforced by another senior manager who notes, "Long term care shows us the failings of our retirement policies. But it is not just American business that has failed; it is also the government and our employees."

For the potential of corporate-sponsored long term care to be realized, the insurance industry and government must assume specific responsibilities to facilitate plan enrollment by employees and their eligible family members.

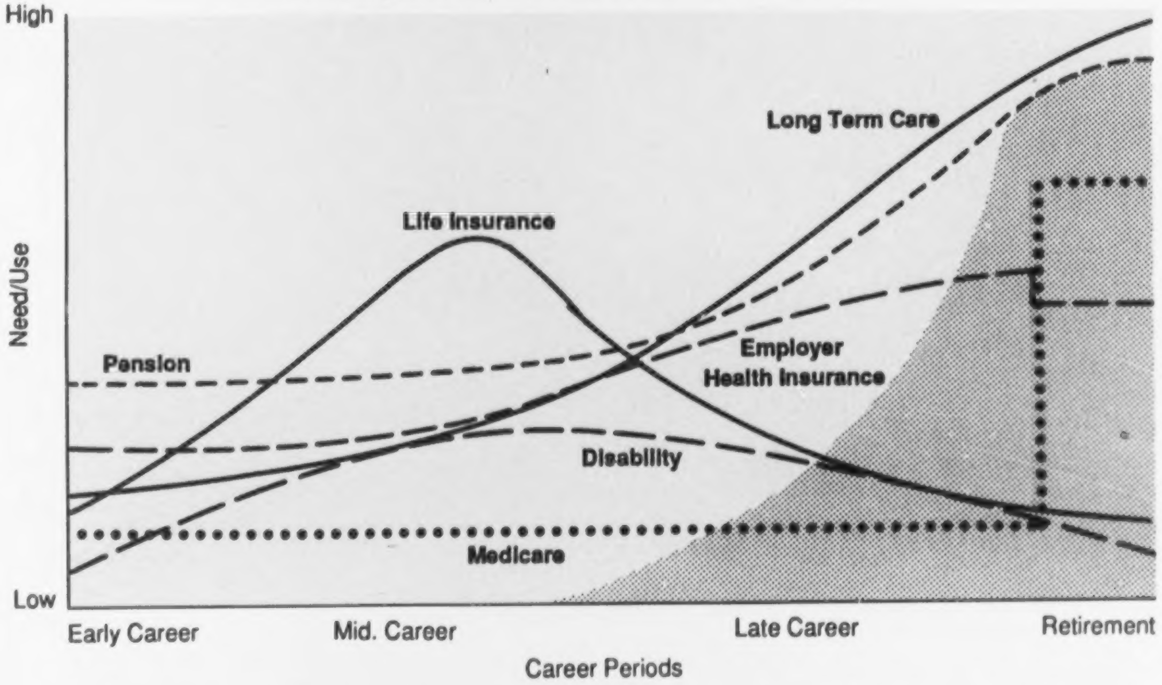
Roles for Employers

Irrespective of a company's approach to benefits, current and potential plan sponsors identify a three-part role in developing successful long term care plans: (1) educating employees about the need for long term care insurance; (2) being the architects of cost-effective plans that ensure employee enrollment; and (3) providing a model to other employers and the public.

The employer as educator. For many plan sponsors, the primary challenge is getting employees to assume responsibility for their own future. "If nothing else," notes one senior executive, "we need to initiate the thought process. As benefits managers, we must get employees to recognize that they are ultimately respon-

Chart 6

Life-Cycle Need for Benefit Coverage*



* This chart is a hypothetical representation of needing/utilizing different health and welfare benefits across a life span. The shaded section suggests how long term care provides an indirect benefit protecting pension and other assets in late life.

sible for their future long term care needs. Like other types of savings, it must begin early, while they are young and actively employed."

The low enrollment figures suggest that selling employees, especially younger groups, on the need for long term care insurance is difficult. "Younger employees think they are immortal," according to one *Fortune*-100 company: "Like 401(k) pension plans and long term disability, it's a hard sell. You can't strong-arm employees into buying an optional coverage."

Designing plans to promote participation. Long term care plans need to be consonant with the sponsor's overall approach to benefits. Plans also need to be seen as affordable and containing provisions that are valuable to a broad spectrum of employees at different ages and income levels. Since most plans are offered to retirees and employees' parents, plans should have features valuable to these other groups as well. However, inflation protection, nonforfeiture, paid-up premiums, and similar options can rapidly increase premium costs and complicate plan administration. The challenge is to balance attractive design options with reasonable costs.

Employers concur that when a company sponsors a plan, it is the same as giving an implicit imprimatur or seal of approval. Corporate sponsorship implies company endorsement of the plan and the concept of long term care. In some cases, this may also imply that the employee is getting better value by purchasing coverage through their employer. One company currently evaluating a number of different plan designs notes, "Our technical expertise enables us to come up with a plan design we can support, implicitly and explicitly."

Several companies believe corporate sponsorship, in conjunction with appropriate communications, will ensure employee participation. For example, one plan sponsor's strategy is to "get our foot in the door with younger employees by making a less expensive plan option available." Over time, the sponsor believes employees will upgrade their coverage on their own as they come to understand and value the benefit.

Other companies assume a more aggressive role by making employee and spouse enrollment a prerequisite for covering parents. As one sponsor suggests, "By forcing employees to be covered before we insure their parents, our goals were not only to increase the penetration levels, but hopefully to help younger individuals recognize why they need this insurance coverage and get them into the habit of covering themselves."

Impact on national and business policy. "It is naive for us to think we can solve all long term care problems," points out one *Fortune*-500 executive, "But I think by assisting our employees and their families, we are somehow helping the government reconstruct the safety net." In essence, companies are suggesting that corporate sponsorship could be one component of a broader national policy. By meeting the potential long term care needs of their employee population, companies allow the government to focus on the needs of other groups with fewer resources.

Sponsors also believe their response will help create a demand and provide creative solutions to the long term care problem. "By offering and publicizing our long term care benefit, we know we stimulate interest," notes one *Fortune*-100 employer. "And there are spin-offs. Our education campaign raised the awareness of non-employees; it also stimulated interest in long term care benefits among our colleagues at other companies."

In addition to improving public awareness, several sponsors believe corporate plans result in innovative programs that shape business and social policy. "By using our technical skills and working with the insurance industry, we are indirectly impacting social policy," states a *Fortune*-100 employer. "Creative employer-sponsored products offer new and different approaches that can be adopted by other companies or sold through individual agents or associations."

Roles for the Insurance Industry

Long term care as an insurance product is in its infancy. Carriers report they have and continue to invest considerable resources to keep their long term care products current and priced competitively. However, the industry is under scrutiny. There is skepticism about the industry itself, its practices and the financial viability of some carriers. As one major employer points out, "We know they are in there to make a profit—and that is okay—but we also know they are going to protect their own interests if something goes wrong." The success of corporate plans will require the insurance industry to ensure affordable pricing, demonstrate a commitment to their long term care products, and create more products and options tailored to the employer group market.

Creative pricing. Pricing premiums is one of the greatest concerns expressed by all groups. "I am not sure the carriers have correctly priced this product," suggests one recent sponsor. "We have built in some protection, but it is hard to know how premiums will change." "One of the greatest difficulties," notes one carrier, "is ensuring premiums are affordable while I keep my product competitive, service clients, and develop new products. I also need to show that our long term care product will be profitable." In essence, it appears that the future price of long term care insurance will be a function of the evolution of the product, the purchaser of the insurance, the carriers' experiences, and what employers can negotiate.

Commitment to the product. The recent bankruptcies of several smaller insurance companies raise questions about the long term stability of the industry. In general, large employers do not see this as a barrier to sponsorship. Among recent sponsors and companies considering plan sponsorship, however, the trend is to spend increasing time reviewing the financials of potential carriers. "We needed to prove to ourselves that they will be here over the long haul," points out one plan sponsor.

Several employers indicate they are less fearful about a carrier filing for bankruptcy than about a carrier or industry-wide decision to discontinue long term care products because the product is seen as neither profitable nor viable due to low participation rates. One way carriers can demonstrate their ongoing commitment to the product is by investing in their products and developing options that will attract increasing numbers of employees and their families.

Some companies suggest carriers need to manage plan costs (and premiums) judiciously while concurrently developing new plan options and design features. As one sponsors notes, "The [insurance] industry has a real balancing act. We are asking them to develop new services, provide open choice of providers, ensure quality, and prevent skyrocketing costs." Employers have several suggestions for new options:

- *Explore ways that enable living benefit riders to work with long term care benefits.* Living benefits, also called "accelerated death benefits," provide access to a life insurance policy while the person who purchased the policy is still alive (see box on page 32).
- *Determine alternative methods for paying benefits.* While most plans pay up to a maximum daily benefit, several sponsors suggest that the comprehensive approach to medical benefits be adapted to long term care insurance. For example, in lieu of a flat dollar amount of $100 a day for nursing home care, the insurance com- pany would pay $80 per day, and the beneficiary would be responsible for the remaining $20.
- *Design alternative payment schedules.* In addition to lifetime and nonforfeiture provisions, several corporations suggest the need for payment schedules to allow participants to pre-pay the entire plan, or, like Group Universal Life Programs, provide alternative payment schedules.
- *Provide for adequate inflation protection.* The lack of systematic strategies to manage health care inflation appears to be of greatest concern to most employers.

Living Benefit Riders

Living benefit policies or riders to life insurance products can be used as an alternative or in conjunction with long term care insurance. These riders provide policyholders access to or "an advance on" some part of their life insurance benefit. Currently, only a handful of companies are offering living benefit riders to group plans.

Living benefits help eligible individuals with terminal or serious health conditions pay for their medical bills, ease financial and emotional burdens, and preclude the chance of bankruptcy resulting in a reliance upon Medicaid or other government relief programs.

Living benefits can be used to pay for long term care services, but, unlike long term care insurance, living benefits may also be used to pay for medical services associated with terminal illnesses, like cancer or a catastrophic/dread disease, such as AIDS/HIV infection. The National Association of Insurance Commissioners requires eligibility for accelerated benefits based upon "qualifying events" that might include:

- A terminal or health-related condition that drastically shortens life span (e.g., under 24 months).
- The need for a health treatment or procedure, like organ transplant, without which the insured individual would die or have a drastically reduced life expectancy.
- A condition requiring continuous institutional care for the duration of insured's life. These institutions might include a nursing home or hospice.

Living benefits are a percent of the face amount of the policyholder's life insurance policy. The money, which can be received as a lump sum or in monthly payments, reduces the total value of the life insurance policy. For example, a terminal cancer patient who takes advantage of a living benefit rider on a $125,000 policy might receive 20 percent or $25,000, leaving a final policy of $100,000. This differs from long term care insurance which provides a maximum daily benefit to eligible participants. Like long term care, living benefit riders have raised several tax issues—like the tax status of received benefits—which have yet to be reconciled.

Lastly, several corporations identify the need for the insurance industry to learn from the current health care cost crisis and, as appropriate, aggressively apply managed care concepts to long term care. The insurance industry needs to explore ways long term care can be integrated with other retiree health insurance products. Says one executive, "In essence, [long term care] is a grey area. As people get older and when you start dealing with catastrophic illnesses and degenerating capabilities, there is a point when it is hard to distinguish what is custodial and what is medical." Thus, there is a need to ensure there are no unintentional incentives to diagnose long term care services as acute care services, or vice versa.

Regulatory issues. Members of the insurance industry assert that long term care products are constrained by regulations geared to the individual rather than group market. These regulations limit the carrier's ability to develop group products tailored to an employer's requirements and specifications. "There has been more than one occasion where two states have different regulations," says one carrier. "For example, it was time consuming and costly when we had to negotiate a group plan when two different states had contradictory nonforfeiture regulations."

Because state regulations vary, decisions to upgrade group plans can make plans so complex that they become administratively unwieldy and difficult to communicate to participants. One sponsor found that variations in state regulations would result in disparate premium increases for plan members including, in some cases, unequal premium increases for two same-aged employees who entered the plan at the same time.

The Long Term Care Task Force of the Health Insurance Association of America has recently presented a series of recommendations to the National Association of Insurance Commissioners. If approved, the recommendations will facilitate the design and administration of employer group long term care plans (see box on page 33).

Roles for Government

From the vantage point of employers and carriers, the government's role should reflect its limitations with respect to long term care and facilitate the growth of private long term care insurance. "I truly believe we can do a better job with some parts of long term care than the government," notes one *Fortune*-500 company. States another benefits executive, "Given the federal deficit, recession, the crisis in our health care systems, and the reality of a global marketplace, it frightens me to think that 100 U.S. Senators can dictate what business should be doing." Employers and insurers believe that before corporate-sponsored long term care can succeed the government needs to clarify current tax law, help educate consumers, and signal its intent with respect to public policy.

Clarify tax laws. To date the federal government has not clarified the tax codes surrounding employer or employee contributions for long term care benefits. Employers say this continues to impede their decision-making on the best methods to design, administer and upgrade their plans.

Despite the lack of clarification, IBM has enabled employees, retirees and their spouses to be reimbursed for a portion of the premiums they pay for coverage under the company's Long Term Care Insurance Program. IBM has taken this approach to demonstrate company commitment to the long term care program and to foster participation in the program. Reimbursements are available under a provision of the company's major medical plan. The reimbursement is no more than a specified percent of the long term care insurance benefits which, according to the carrier's conservative analysis, is attributable to medical expenses. IBM minimized the net additional cost to the company by subjecting these reimbursements to the same $500 overall annual maximum that already applied to plan reimbursements for various preventive health services and certain other medical expenses (e.g., eyeglasses).

Two other large employers—who declined to be cited for this study because the Department of the Treasury has not issued a ruling on the tax status of employee contributions—have taken an alternative approach. These companies allow employees to use pre-tax dollars to pay part of their premiums. The sentiment in the business community is clear: Until the government comes to a decision—in either direction—plan sponsorship will certainly be hindered.

Most sponsors and carriers believe giving a tax deduction or credit to plan participants and/or the sponsors will increase the number of plans and improve participation rates among employees and their families. They suggest several different approaches for structuring the deductions:

- *Allow employees to pay for all or part of their premiums on a pre-tax basis.* Employers have administrative vehicles, like health care spending accounts, through which employees could pay for long term care insurance premiums on a pretax basis.

- *Develop long term care Income Retirement Accounts (IRAs) and 401(k)s.* Long term care IRAs or 401(k)s are seen as alternatives to spending accounts. Through these plans, employees receive a tax credit for saving towards their long term care needs. Employers believe this is an effective vehicle for two reasons: 1) participants would see a tangible growth in their personal estate, and 2) employers, through 401(k)s, could provide a match for participation. It might also stimulate plans among smaller employers.

- *Provide tax deductions to employers who contribute to long term care benefits.* Given escalating health care and benefit costs, most employers do not foresee paying for long term care premiums through "new" money. However, several believe the number of plan sponsors would likely increase if employers could receive a tax deduction for contributions through cafeteria plans or similar vehicles.

Recommendations for Employer Group Plans

Because there are distinct differences between group-sponsored and individual long term care markets, the Health Insurance Association of America's Task Force on Long Term Care has presented a series of recommendations to the National Association of Insurance Commissioners. The general purpose of these recommendations is to facilitate plan sponsorship by creating regulations that will govern conditions specific to the employer group marketplace. The task force report contains these recommendations:

- **Ensure that existing consumer protection provisions are revised to reflect the group market: Existing disclosure requirements are geared to the individual insurance agent. The proposed regulations will simplify requirements that employees receive redundant materials, like those contained in Summary Plan Descriptions.**

- **Allow employers to make design decisions: By allowing employers to tailor plan features to company-specific requirements, this revision will help ensure that the plan design matches the company's demographics and dovetails with other benefits. Additionally, it would make it easier to control premium costs and simplify plan administration.**

- **Provide guidelines relating to continuation and conversion: This would help plan sponsors keep their plans current and provide guidelines for changing carriers.**

The government as educator. Irrespective of any decision on tax deductions, all interviewed companies believe government can increase public awareness about long term care and the need for individuals to protect themselves. Specifically, through public-funded research and education campaigns, similar to those for high blood pressure and AIDS, the government could stimulate interest among individuals. Through increased public awareness, participation in employer-sponsored plans would likely increase, thus lowering the overall costs to the public sector of uninsured Medicaid patients.

Defining government's position. Any discussion about government's role with respect to employer-sponsored long term care ultimately becomes embedded in the larger issue of American health care policy. While this debate raises complex and intertwined issues, there are several key areas where government could signal its intent to the business community concerning corporate-sponsored long term care. These areas include:

- *Evaluate the need for short term revenue versus long term costs.* The Government's current position emphasizes short term revenue to reduce the deficit; however, this may be shortsighted. Providing tax relief for employers and/or employees would likely increase the number of plan sponsors and participating employees, and provide a longer term solution to the projected costs for long term care.
- *Determine federal and state interests on long term care costs.* The cost of long term care falls heavily upon state governments, mostly through welfare programs and Medicaid. Therefore, there appears to be an apparent conflict in the needs of state and federal government, which ultimately impacts business and individuals through taxes.
- *Ensure that government initiatives do not penalize companies that sponsor long term care programs.* There is a fear that government's response to the long term care issue might be antagonistic to business. For example, it might include a new entitlement program, mandated long term care plans, or result in some other scenario—similar to the return of premium requirements of the repealed Medicare Catastrophic legislation—that penalizes employers who take the initiative to sponsor an employer plan.[4]

To balance public and private interests, several carriers and sponsors believe that a new amendment to the original Medicare legislation might prove beneficial to all affected groups including government, employers, carriers and employees. For example, a public plan could complement corporate long term care plans by meeting some deductibility requirements or increase benefits to plan participants.

Conclusion

Long term care as an issue affecting American business can only become more visible as the U.S. work force becomes increasingly diverse and the number of older Americans—working and retired—continues to grow. As a response to these trends, corporate-sponsored long term care insurance has emerged as a new benefit that is included in or under consideration for many benefit packages. Because it can help employees and their families create a personal safety net, the insurance industry and employers view long term care as a potentially invaluable benefit.

While the number of plan sponsors has increased rapidly, and in concept, employer-sponsored programs hold great promise, many employers are cautious about this new benefit. It is in the best interests of business and the public to increase the availability of long term care to employees and their families. However, employers, insurance carriers and government must work together, with each group assuming specific responsibilities, to make the product work. Employers who sponsor long term care plans are taking a leadership role; they are both protecting employee assets and helping to shape a United States long term care policy.

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[4] The repealed Medicare Catastrophic legislation included a return of premium provision. Had the legislation been enacted, many plan sponsors would have been required to value that portion of their retiree health benefit plan paid for by Medicare and reimburse some portion of that amount to retiree plan participants.

Related Publications

Encouraging Employee Self-Management in Financial and Career Planning, Report No. 976, 1991

A Bottom-Line Perspective on Health Care Costs, Report No. 989, 1990

Implementing Managed Care, Report No. 968, 1991

Retirement Planning: Corporate Perspectives for 1990s, Perspectives No. 20, 1990

A Life Cycle Approach to Family Benefits and Policies, Perspectives No. 19, 1989

Health Care for Retired Employees, Research Bulletin No. 202, 1987

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by Audrey Freedman

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The Conference Board's annual meeting of human resource experts was held on November 7, 1991. Panel members discussed the current economic situation; the Free Trade Agreement between the United States and Canada; the negotiations over a North American agreement between the United States, Canada and Mexico; education; compensation trends; human resource developments; and political events. This process provided the predictions for 1992 that are reported in the table on page 7. The views quoted were submitted by the participants in writing prior to the discussion. Alan R. Ewalt was not present at the meeting; however, his written views have been quoted in the report.

About the Author

Audrey Freedman is Management Counsellor at The Conference Board. She has been a supervising economist at the U.S. Bureau of Labor Statistics and a member of the staffs of the U.S. Cost of Living Council and Pay Board. She has published over 50 studies on economics, human resources, and management subjects for The Conference Board and leading business journals. She is a member of the Board of Directors of Manpower Inc., and of its Compensation Committee.

From the President

For 15 years The Conference Board has provided business executives with an outlook on human resource issues as seen from the perspective of a special panel of operating executives and human resource experts. The panel attempts to look ahead one year, and more, in identifying and discussing the important issues that will challenge present and future human resource managers.

This year, in addition to focusing on domestic events, the panel discussed North American free trade and its likely implications for human resource issues in the 1990s.

We appreciate the participation of the active and involved members of the Outlook Panel, who generously contributed their time and expertise to the report.

PRESTON TOWNLEY
President and CEO

Executive Summary

The Conference Board's Human Resources Outlook Panel expects a weak economic recovery, with minimal job growth in late 1992. The absence of any cost-push elements in the economy will permit slow restoration of profit margins, and make a longer, more sustained recovery possible. This recovery will not echo the strong growth that followed the 1981-82 recession because the high debt levels that developed over the past decade have left little possibility for stimulation now.

Most of the concerns surrounding the U.S. free trade agreement with Canada, and a proposed agreement with Mexico, involve human resource functions—not management functions. Migration of jobs may occur as a result of a comparative advantage in (1) labor costs—through combinations of higher productivity and lower wages—and (2) in the quality of worker output. Education and training of work forces is thus fundamental to maintaining competitive advantage in global markets.

Health care problems in the United States will not begin to be resolved during 1992, although there is movement toward a national policy. Political focus is more intense this Presidential election year, and it is possible that the general direction of policy change will be discernible by the end of the year.

Continued cost-cutting and other attempts to restore competitive position have led to more "churning" of the work force. Employees on contingent or short-term jobs, and insecure recruits, never develop a sense of corporate purpose, work community, and standards of performance. As a result, human resource executives must find new ways to create mutual commitment among all employees to a common organizational purpose.

Human Resources Outlook 1992

The Outlook Panel forecast that the recovery expected in mid-1992 will be exceedingly weak in terms of job generation. There will not be enough economic growth to relieve the public's greatest fears: job loss, loss of access to health care, and health care costs. The enormous accretion of debt during the 1980s has crippled the nation's ability to generate a recovery or to deal with certain domestic problems.

In spite of these sobering conditions, the prevailing mood of the panel was upbeat in part due to the feeling that the worst of the recession is over and that the foundation for a stronger, longer recovery has been built. Positive news includes a low rate of inflation and general exhaustion of any cost-push factors in the economy. Service industries have begun to streamline and rationalize their operations by paring away excess—including entire business lines—that impedes competitiveness. Manufacturing has been undergoing this process for some time, with continuing benefits. Progress is being made toward a free trade grouping of Canada, the United States and Mexico that will benefit the parties over decades.

The panel's cheer also seemed to be in response to a shift toward "knuckling down" to work. During the past few years of economic stringency, Americans appear to have developed greater "realism" and self-reliance. This may reflect a lowering of expectations, or an acceptance that any improvements in our standard of living are going to be hard-won. Perhaps an undercurrent of guilt about the careless '80s has stimulated our spirit: We know it is time to pay our debts.

Overall Economic Outlook

Current unemployment rates of 6.8 percent (fall 1991) are expected to continue through early summer 1992 (see table). The narrow range of individual forecasts indicates general consensus that any recovery in the labor market will be delayed; a few pessimistic panel members expect a significant increase in unemployment in the first half of the year.

The second half of 1992 will begin to show improvement—but not much. Even the most optimistic panel member does not expect the economy to grow enough

Forecasts for 1992 by The Conference Board's Human Resources Outlook Panel

	Median	*Range*
Increase in employer costs for wages and salaries in private industry	3.9%	3.4 to 4.7 %
First-year wage increases in major union contracts	3.4	2.9 to 4.0
Increase in labor costs per unit of output in manufacturing	0	− 1.0 to 1.5
Rate of inflation (annual increase in Consumer Price Index)	3.5	3.2 to 4.5
	Average rate of unemployment during 1992	
First quarter	6.8	6.7 to 7.4
Second quarter	6.8	6.5 to 7.2
Third quarter	6.6	6.0 to 7.0
Fourth quarter	6.5	6.0 to 6.8

Audrey Freedman
The Conference Board

in the next year to reduce the unemployment rate below 6 percent. The rate fell to 5.5 in 1988, 5.3 in 1989, and rose back to 5.5 in 1990—all at a time when the labor force was growing faster than it has been this year.

Cost-push elements in the economy are expected to be extremely mild. Almost unanimously, panelists forecast that labor costs per unit of output in manufacturing will not rise. This contrasts with the year ended in the third quarter of 1991, when a 2.9 percent increase occurred. Under such circumstances, opportunity for profit growth exists if sales and production begin to rise.

Overall pay increase is forecast to be modest, slightly above the current Employment Cost Index rise of 3.7 percent during the year ended in the third quarter of 1991. However, the recession of 1991, topped off with a weak job market recovery, might be a greater drag on pay than the Panel predicts. Since today's wage offers are based on low labor demand and high supply, the labor market will be "loose" for more than a year to come.

Typically, salary increases in surveys conducted by compensation specialists are higher than pay boosts for the entire economy, and in the 1992 projections this difference is substantial: salary hikes cluster around 5 percent (see table on page 9). Benefit costs were excluded because they are rising independently, seemingly unaffected by the economy; however, they are having a political effect (see "Government Regulation of Human Resources" on page 16).

The rate of consumer price increase is forecast at a moderate 3.5 percent. This figure probably reflects the absence of any cost-push influence since it is close to the current annual rate of 3.3 percent annual (as measured in the third quarter of 1991).

Panelists expressed frustration with the economy's slow response to recovery efforts. David Lewin said:

> "The problem with this picture is that we should be doing better than we are at present. After all, most firms have pruned their overhead and work forces; labor strife is exceedingly rare; unit labor cost pressures are modest; the manufacturing sector is quite productive, including relative to other nations; and interest rates are low. This could reasonably have been expected to result in a milder and shorter recession than has been experienced. In fact, if you believe the Bush Administra- tion, the recession was mild and is now over! I don't believe this."

Overshadowing this stagnancy is a Presidential election year, with its usual impetus to stimulate the economy with deficit spending. According to Rex Adams, "The federal deficit, combined with the political dynamics of the budget agreement, severely limit our options for injecting a fiscal stimulus. Current talk of tax cuts funded from defense savings is unlikely to come to much in the near term because the numbers don't work." Finally, lowering interest rates has not generated much lending because the banks must first work out severe credit quality problems. Moreover, business has not seen opportunities strong enough to motivate more borrowing.

From a business executive's point of view, Richard Sullivan's summation offers prudent advice:

> "We will be facing a continuing task of relentless competition where we will have to be at our best all the time—or someone, or some nation, will be ready to step in and do it for us...Every organization should go into 1992 with a contingency plan for dealing with the downside. It's going to be hard every step of the way."

Specific Industries

Panel members come from a wide variety of industries and regions. Those in services generally have major business customers, and thus are exposed to conditions in primary or secondary goods-producers. A sampling of their observations follows:

> "The defense industry has a unique situation: businesses that develop and build products that require seven to ten years from design to production must do their strategic planning off the front page of the *Wall Street Journal*. Major defense firms that underpin large communities—read southern California—are in a free-fall that no one is prepared for." (Ted Westerman)

> "California is already lagging the rest of the nation by most economic indicators (for only the second time in the nine recessions following World War II), and it will surely lag in recovery even without additional defense cutbacks. Aerospace and other high-tech industries bear the brunt of these cutbacks, with some related impact on construction." (David Lewin)

> "Lead times for deliveries of steel have begun to lengthen, but a cooling Japanese economy will probably result in increased supplies flowing into international markets. That undermines any chance of major increase in steel activity. But, in the steel business where U.S. consumption is in the hundred million ton range, 'the difference between a glut and a shortage is one ton.' " (Roger Phillips)

> "Several industrial sectors that are of particular importance to Conrail seem to be vulnerable: steel, auto and construction. On the other hand, some of the 'bulk'

A Survey of Surveys: Salary Plans

Organization	*Level of Employee*	*1991 Salary Increase*	*1992 Planned Salary Increase*
American Compensation Association	Executive	5.1%	5.2
	Exempt Salaried	5.0	5.1
	Nonexempt Salaried	5.0	5.0
The Conference Board	Executive	5.0	5.0
	Exempt Salaried	5.0	5.0
	Nonexempt Salaried	5.0	5.0
ECS, Inc. A Wyatt Data Services Company	Executive	5.3	5.3
	Exempt Salaried	5.0	5.1
	Nonexempt Salaried	5.9	5.9
Hay Management Consultants	Executive	5.5	5.5
	Exempt Salaried	5.1	5.0
	Nonexempt Salaried	4.9	4.5
Hewitt Associates	Executive	5.3	5.4
	Exempt Salaried	5.0	5.1
	Nonexempt Salaried	4.9	5.0
William M. Mercer, Inc.	Executive	5.6	5.4
	Exempt Salaried	5.2	5.1
	Nonexempt Salaried	5.1	5.0
Sibson & Company, Inc.	Executive	5.6	5.3
	Exempt Salaried	5.1	5.0
	Nonexempt Salaried	5.0	4.9
Towers, Perrin, Forster & Crosby	Executive	5.0	5.1
	Exempt Salaried	4.9	4.9
	Nonexempt Salaried	4.8	4.8

1991 salary increases were considerably lower than projected last year. As the economy remained uncertain, companies scaled back pay increases to contain costs. Salary increases in 1992 are expected to be virtually the same as 1991. However, there will be a real earnings gain for employees if inflation, currently projected to increase by 3.2 percent, continues to lag behind salary increases.

Elizabeth R. Arreglado
Research Associate

Data compiled by:
Marie R. M. Buenaventura
Research Administrative Assistant

Richard Sullivan
Consolidated Rail Corporation

> commodity industries may have an upturn for reasons that are ancillary to the direct health of the economy. These include coal (where utilities have needs arising in a change of fuel); grain (where exports may grow); and, over a longer period, trash and recyclables as site locations are approved.
>
> "But, even a strong economy doesn't guarantee growth in the share of the transportation market captured by railroads. During the 1980s, with the longest postwar upturn in history, railroads lost billions in market share to trucks—because truckers learned to do what the customers wanted them to do." (Richard Sullivan)

> "We see continued market growth, but not as robust as in the past. Individuals and corporations are watching their spending and we feel it." (John Zimmerman)

Madelyn Jennings looked at the business cycle in terms of advertising:

> "The domino effect of mergers in such industries as banking, airlines and retailing often means there is one advertiser instead of the previous two or three. Moreover, the average U.S. adult is exposed to 3,000 marketing messages a day, so getting noticed is the challenge. The outcome of this has been a proliferation of targeted media all vying for the same advertising dollars.
>
> "Those dollars will be spent very carefully. 'Advertising agencies and advertisers are looking for ideas first, value second and then service,' says *USA Today* Associate Publisher, Carolyn Vesper. Little if any space will be purchased without a plan as to the impact of the advertising.
>
> "Our advertising executives believe national advertising will be marginally better in '92. We project continued advertising strength in travel and travel-related services, import automotive, telecommunications and computers and office equipment. We also see development of more regional promotions for packaged goods. But it will be a time of slow, steady improvement versus a dramatic recovery. We hope to reach 10 percent growth (after two poor years) on the national advertising side, helped to some extent by the Olympic Games and the elections.
>
> "The retail advertising industry (which contributes more than 50 percent of newspaper advertising revenues) shows few signs of strength in the near future. Newspaper advertising rate increases are predicted in the 3 to 5 percent range, lower than the 5 to 5.6 percent of 1991."

Sales recovery leads to increased production, which ultimately generates employment. Additions to payroll numbers are derivative and somewhat delayed. There is, on the other hand, an industry that could be described as the labor market itself: temporary help services. Its product is flexible labor supplies that respond instantly to change in business demand. In a sense, if there is any sign of rising business activity, especially if the improvement is uncertain at first, it will lead to demand for more temporary workers. Mitchell Fromstein described his industry's current situation:

> "While employment historically lags general recovery, the use of temporary help has been a leading indicator. Demand has been increasing modestly but continually since mid-summer, and those increases are tracking the 1982 recovery pattern. On the basis of this record, I expect that job formation will recover very slowly.

Mitchell S. Fromstein
Manpower Inc.

> "It will take six to eight quarters to absorb the excess supply of labor, particularly at the middle-management level. Downsizing is still taking place. On the other hand, we have seen continuing demand for temporary workers in manufacturing throughout 1991, particularly in the Midwest and Southeast, because the weak dollar has been enhancing exports."

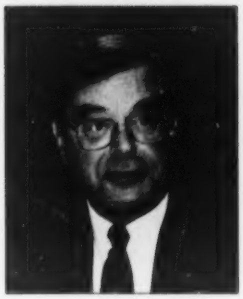
Sweeping through the discussion of cutbacks in employment is a recognition that the job market has changed fundamentally. In previous recessions manufacturing workers were hard hit by layoffs, but those layoffs were often followed by either recall or rehiring in another factory. Less and less typical during the '80s, this pattern seems to be gone forever. Manufacturing has improved productivity to the point where fewer first-level workers are needed, and the ones still necessary must be equipped with advanced skills that are scarce in the U.S. work force. This has again highlighted a training deficit developing over more than a decade (see "Technical Training" on page 15).

Rex Adams covered many specific industries in his description of the current recession, but then explained why their deterioration is about to reverse:

> "The corporate sector is still struggling to regain profitability in a low inflation environment. The automobile industry is a disaster. Commercial banking and insurance companies have only begun to shake out. Construction and home building are way off. Equipment manufacturers, ranging from IBM to Caterpillar to Tenneco, are in deep trouble. The defense industry is contracting rapidly. The media businesses are awful. Chemicals are depressed. The retailers are in the doldrums. That leaves health services and pharmaceutical industries as profitable, and an outrage to the rest of us. Now, when corporate profits weaken, the effect on employment is almost instantaneous. Companies are no longer willing to ride out bad times without taking immediate measures to get costs down; and the quickest way to get costs down is to get people out. And that's what's happening. Even governors and mayors are doing it.
>
> "All of the evidence suggests that consumers are both pessimistic and worried. They're worried about job security; frightened by the cost of medical benefits and medical treatments. They perceive that they have lost asset value in their homes and savings accounts. They are concerned that their banks might not lend to them. And, even if they are securely employed, they haven't experienced much growth in their after-tax income recently and their consumer debt is already high. So, in that frame of mind, they aren't ready to spend us into an economic boom.
>
> "Having said that, I come back to my basic sense that the economy will work its way out of this recession in the course of 1992. The worst is behind us; we've seen the bottom. Housing and commercial real estate should get slowly better in a low interest environment. The exchange rate on the dollar is about right and most of the corporate sector should begin to make some money abroad while improving their U.S. margins through more cost-efficient operations. A lot of other businesses, particularly service related, have nowhere to go but up. Inventories are in good shape. Much of the nutty financing stuff of the late-'80s is behind us and credit quality has generally improved. In short, there seems enough to go on to get some growth started next year—not spectacular, but solid growth."

North American Free Trade

Labor market and human resource management issues are at the heart of nearly all discussions surrounding free trade with Canada and Mexico. Porous national borders are a great threat to inefficient managements and unproductive workers. Any potential job losses, particularly in manufacturing, excite political nerves in the United States and Canada. It is very difficult to describe, especially, for example, in the few words allotted to a sound bite on television, the more generalized benefits of fluid and growing markets.

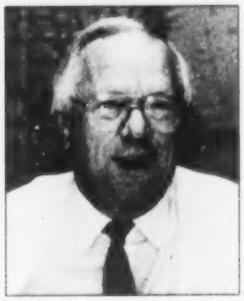


Rex D. Adams
Mobil Oil Corporation

The U.S.-Canada Free Trade Agreement, effective 1989, continues to open trade opportunities between partners. Now, negotiations between the United States and Mexico has begun. Eventually, a North American bloc may erase remaining economic and business borders, with an opening to the south.

Relative worker productivity and labor costs per unit of output help determine where work will be done. Panel members expect that some jobs may migrate to Mexico. Primarily because U.S. (and Canadian) productivity in certain labor-intensive industry sectors is not high enough to sustain the current wage rate. Mitchell Fromstein pointed out that this kind of movement has been going on for years:

> "The stress points in NAFTA will be work force costs and productivity levels. Those stresses certainly exist now with access to low-cost labor in Ireland, Portugal, India and Southeast Asia. To the degree that U.S. jobs will be lost to Mexico on the same basis, it seems better when open markets provide economic opportunity for American products and services, which could mean more jobs at home. Initially, there will be bruises somewhere for all of these economies. However, I believe that U.S.-based jobs will continue to grow as a result of the adjustments, and that U.S. systems and management will appear in Mexico as appendages to U.S. operations rather than replacements.
>
> "Canada is a different situation. Much of the Canadian manufacturing base resulted from protective historical site requirements of the Canadian Government. It was anticipated that a Free Trade Agreement on manufactured products would not result in the closing of U.S.-owned plants in Canada. However, many U.S. firms, driven by the need for competitive restructuring and pressured by the recession, folded or compressed Canadian operations. As a consequence, I expect the Canadian negotiators to hold firm on maximum U.S. content (of tariff-free goods) of 40 to 50 percent in an effort to protect the Canadian work force."



Roger Phillips
IPSCO Inc.

Job Migration

Our member from Canada takes this in stride, but suggests that there are differences between the U.S.-Canada and the U.S.-Mexico relationships. There was consensus in the group, in fact, on several points of difference. Roger Phillips observed:

> "I believe that NAFTA will end up as a relatively narrow pact when compared with the U.S.-Canada agreement. Mexico will gain tariff reductions for products shipped to the United States while Americans will become, by treaty, more welcome investors in Mexico. The treaty will include safeguards to preclude other parties such as the Japanese from gaining duty free access to the United States by the back door. Concerns about low wage costs in Mexico should be discounted almost completely. Just as has already happened in South Korea, wages will rise with skill and productivity. In other words, economics will still work!"

Dan Mitchell described the relative position of Mexico as a source of low-cost labor. In fact, this competitive advantage will continue for years to come:

> "Adding a Mexican labor force of about one quarter of the United States' via trade is a significant increase in labor supply. Moreover, the Mexican labor force has a large pool of unskilled workers. The proportion of the Mexican labor force in production/operative occupations is roughly comparable to that in the United States (one-fourth). But Mexico has another fourth in agriculture, compared with about 3 percent in the United States. So Mexico's comparative advantage will be in unskilled, low-wage, labor-using industries—and the Mexican wage in manufacturing is only about one-eighth the U.S. level."

Political opposition to U.S.-Mexico trade has focused on potential job losses for the lowest-wage workers, even though the unions campaigning against open trade generally represent much higher-paid workers. However, unions continue to be interested in increasing wages for workers from the bottom of the scale up to their members' pay levels. This is the meaning of the slogan "take wages out of competition." In the discussion it was pointed out that wages have been falling in the United States, relative to other countries. Now, there is a "bogeyman"—Mexico.

The discussion of job migration returned repeatedly to human resource development. One comment was: "We in the United States don't have a sense of the strategy of developing high value-added industrial activity by investing in our workers." We cannot just be a market; we must be concerned with the long-term fate of our society. John Zimmerman pointed out that job competition is affected by human resource investment:

> "With no changes in how we do business here in the United States we will find ourselves stripped of jobs in every labor-intensive industry. Further, the investment that we need so badly in the United States will migrate right along with the jobs.
>
> "The answer is to develop competitive workplaces in the United States: Workplaces that have a competitive work force in skill and ability—which we clearly do not have now; workplaces that provide support systems to the production of products and the provision of services. In this regard, we constantly fail to capitalize on our technological advantages. Most important, we must put quality standards in our workplaces that are second to none.

John Zimmerman
MCI Communications Corp.

> "If we fail to take these steps and continue down the path that we're on, we'll be betting our country's future on wage levels and this will mean drastically reduced wage levels for nearly all workers in the United States. We will just fall further and further behind."

This criticism stimulated the observation by David Lewin that not all of Mexico's industries involve low-wage, low-technology labor:

> "One additional notable feature of the Mexican economy is the emergence of 'high quality' manufacturing, in for example, automobiles, electronics, and steel products. I believe that this achievement has been overlooked somewhat. Under a new scenario of freer trading relationships, it is likely that foreign investment will be attracted to Mexico for quality enhancement reasons, not just for low-wage reasons. If so, then the pace of foreign investment in Mexico may expand dramatically, and so too will upward pressures on wages."

One interpretation of the benefits of a North American free trade agreement is that it is a necessary response to an emerging world of trade blocs. One panel member observed:

> "We are better off if low-wage work goes to Mexico rather than the Far East or Europe. Benefits are greater if exchange is within the (North American) bloc."

Ted Westerman discussed this bloc in expansive terms:

> "The proposed U.S.-Mexico free trade agreement is one of the bright spots in our economic picture, not only for the rest of this decade but also into the next. When joined with Canada, it represents a potentially formidable trading bloc, particularly in the context of the now semi-moribund EC-'92, and the more important trading of our Pacific Rim neighbors. Not just for the three initial partners, but as a precursor to an All-American (North, Central and South) free trade bloc for the 21st century."

Luis Porfirio Diaz
BANAMEX

Luis Porfirio Diaz described some of the benefits that he expects to develop within Mexico. In general, he sees open borders as having a liberalizing effect, more in political terms than economic. He also reminded the group to think of opportunities for social integration:

> "A free trade agreement should facilitate competition with the European Community and Japan as the major developed markets in the world. But, if the vision promoting the agreement and the engineering are purely economic, we will miss the real value of this historic opportunity. Economic development should not be merely a fine tuning of asymmetries among regions, countries and systems. It has more to do with venturing into an advanced way of dealing with diversity, freedom, democracy and solidarity—redefining alliances and relations.
>
> "A free trade treaty implies conditions that will force alliances of diverse forms, aimed to increase competitiveness and to open the economic system so more flexibility in foreign investment regulations will occur.
>
> "Labor unions are becoming less active in defending ideology. They need to discover relevant needs of younger generations, like more jobs and less social recruitment.
>
> "Regulations protecting the environment will be tightened in accordance with international standards.
>
> "Strong attention will be concentrated on preparing the financial system to compete at a global level. More healthy government finances will be on the front pages of 1992 Mexican newspapers.
>
> "Government is committed to facilitate technology transfer; scientific and technological projects will find a more receptive officialdom. Franchises in this area will move fast."

Education

From its discussion of trade and national competitiveness, the panel moved into the subject of educational preparation of the work force. John Zimmerman phrased it this way:

> "The proposition is simple. We have to change our trade balance. We have to stop exporting jobs and calling for trade barriers to slow the import of products. We must build a competitive work force so we can export products, not jobs."

The country spends "massively" on education, but this has got to be the least effective use of social capital, observed one panel member. Another member said schools continue to push problems into higher and higher age groups, passing the problem onward until it becomes impossible to remedy.

That lead to a discussion of measurement and testing. According to Dan Mitchell:

> "We need a universal or random-sample test of all high school students to check on proficiency. No data; no solutions. Ultimately, though, after all of the testing and after all of the President's moral suasion to raise standards, we will have to throw money at this problem.
>
> "Teachers in Europe, for example, have a highly respected status compared with teachers in the United States. If we want to raise the salaries of all U.S. teachers by 50 percent, it would cost about one-and-a-half percent of the GNP. Is that a lot? It could be done out of currently projected defense savings. But it will not be

Daniel J. B. Mitchell
UCLA

Madelyn P. Jennings
Gannett Company, Inc.

done unless the first step is available: documentation of what exactly goes on in high schools. So that's why I would start with testing."

There seems to be general agreement among panel members that national-level testing is a route to raising standards. It would also lead to more centralization. Madelyn Jennings advocates this move:

"President Bush's America 2000 program calls for voluntary national achievement tests. Other countries do test. Why not us? The 'think global, act local' method of carrying out our education system under the auspices of local boards of education is an anachronism. Why, for example, should a child born in Bridgeport, Connecticut be less deserving of a good kindergarten to 12th grade education than one born in New Canaan, Connecticut?

"Labor Secretary Martin's Commission on Achieving Necessary Skills (SCANS), on which I serve, will be defining the basic competencies needed for many entry-level jobs. Its final report will be issued in 1992 and deserves careful study and support from educators, business, local government, all constituencies. It ties in directly with the America 2000 program.

"Teachers need help. They need to be relieved of bureaucratic paperwork. Multimedia technology can revitalize the role of the teacher as facilitator and coach. IBM's pilot multimedia programs, for example, could be used in solving education weaknesses and responding to the way today's young people learn fastest!

"Currently, education majors come from the bottom quartile of SAT scores. We need to make teaching the respected profession it once was through adequate pay, recognition and training and to upgrade teachers' knowledge of technology. We also need to raise our expectations of what children can achieve. We should lengthen the school year. We should make children who flunk take extra coaching in the summer. Apprenticeship programs should proliferate."

David Lewin supports a radical solution. As long as national standards and testing are being discussed, he proposes, why not place the entire school system within the U.S. Department of Defense? His reasoning is based partly on the argument that a strong economy is a matter of national survival, and that kind of economy depends on a quality labor force. The other part is that we in the United States have not been parsimonious on defense spending:

"With respect to reforms of the educational system, one must ask how the United States can have a public school system which is widely decried while also having a higher education system that attracts students from around the world? One answer is that public schools can't choose their students, whereas higher education institutions (for the most part) can. One implication is that the time has come for the end of compulsory education in the United States. I don't think this will happen in the 1990s, though it deserves debate. Voucher systems and other elements of choice are potential first steps in generating such a debate.

"At the opposite end of this policy-oriented spectrum is to declare public education as a weapons system. Place the Department of Education within the Department of Defense. Instead of defense cuts, shift defense expenditures from hardware to schooling, competency testing, universal certification standards, and the like. Again, I don't envision this happening in the 1990s, but it deserves debate.

David Lewin
UCLA

"I suppose a more realistic starting point is to know exactly where we are in public education. I agree that we need a single, universally administered test (for example, given to high school students) to get an accurate, generic measure of skills, competencies and knowledge. Once this were done, we would be in a better position to know what additional resources will be required to achieve certain objectives with respect to skill, competency, and knowledge level objectives.

"And make no mistake about it, this problem, like most others, has an important economic dimension. If we really want to lengthen the school day and year, require 'hard' subjects of all students, supplement formal schooling with in-the-home schooling, attract higher quality teachers and administrators to the schools, resources will be required. Can anyone really doubt this?"

Technical Training

One of the major problems for employers seems to be technical skills, or at least sufficient preparation in mathematics and logical thinking to serve as a foundation for technical training. Rex Adams stated:

> "Both capital and technology require advanced skill sets in the people associated with their application. These skill sets are partly social and partly conceptual. To the degree that they are conceptual, they rest on a core mastery of mathematics and science. Nobody with walking-around sense can be satisfied with the level of preparation our children are getting in these critical disciplines, relative to our own past standards or in comparison with the societies we compete against economically."

The hospital services sector has traditionally had an image of scientific proficiency at the top, supported by many caregiving personnel whose main skills are interpersonal and empathetic. Hospitals also had large groups of relatively unskilled workers involved in maintaining facilities, handling housekeeping and food services, and administering records and finances. Alan Ewalt pointed out that this era is finished; all of these jobs now require advanced technical skills:

> "The hospital industry is looking for persons well prepared to deal with highly technical environments. That not only means workers who understand the operating principles of a computer, it means people with the basic skill to absorb large amounts of technical, numerical and verbal data, and to translate these facts into decision-useful management information.
>
> "Our hospital maintenance personnel, dietary personnel and other disciplines that usually require only a high school diploma plus advanced certification in their field are now faced with: reading and understanding regulations; operating computer-based monitoring and operational programs; and communicating, both orally and in writing, concise reports, observations and analyses of an operational nature."

There are some dilemmas for managers. If they invest in long-term needs for a trained work force, they may be accused of wasting precious resources needed today, on the *possibility* of a future need. Moreover, such spending may redound to the interests of another employer, since both students and employees are mobile and may take the investment elsewhere. Ted Westerman concludes that the most prudent path is to develop joint training programs with schools to "recycle" present employees:

> "Those of us in high-tech business are alarmed by the probability of a shortage in the mid-'90s of skilled employees. Today, however, we find ourselves with an excess.

Alan R. Ewalt
National Medical Enterprises

> "We are now laying off substantial portions of our best-trained work force because there is no work to support their retention. Because of productivity increases, we would be reducing some level of employment even if business remained constant. It is very difficult to persuade our boards of directors that we must now develop an infrastructure to prepare for that perceived shortage. What if we're wrong?
>
> "Graduates coming out of our technical universities are increasingly foreign, and a great many of those graduates are leaving the country. There is also a large flow of minorities into the work force. Educational preparation is not adequate to provide the quantity and quality of employees that we need.
>
> "All this leads to my conclusion that businesses must set up an infrastructure to recycle their employees from disciplines that become outdated, into those that meet requirements for the future. We must work in partnership with the educational institutions to bring this about."

In terms of the whole society, however, high technology skills represent a small segment of need. The entire panel described situations in which new workers or applicants are unable to read, reason their way through a sequence of actions, or diagnose a problem logically. Some referred to high school and even college graduates—not school dropouts. General thinking ability is the issue that covers the entire population. Mitchell Fromstein pointed out:

> "The lack of a current shortage masks a future problem that will emerge as the recession and downsizing come to an end: fewer entrants, more dropouts, and lower levels of work-readiness.
>
> "I believe that while better educational quality is needed, we are not going to be a society comprised solely of technicians and engineers. It is a fact that 70 percent of our work force functions at very low technology levels that can be taught or trained to almost anyone if a strong initiative is developed.
>
> "Educational reform should be aimed first at the disadvantaged and socio-economically dislocated. The objective should be work-related skills that can qualify them for work force entry.

Gene R. Remoff
ARA Services, Inc.

> "One cannot move easily or succeed in the labor market if one is not in it. It is true that females, immigrants and minorities cannot move easily or as far as others in the present work force but the 'classes' are slowly dissolving and opportunities to advance will improve for those who pursue them. It is the best we can hope for in the short term."

Gene Remoff closed the discussion with a charge to human resource professionals—make noise about training and education! Perhaps those most damaged by weak public education are corporations, but executives may not fully recognize this. Remoff wants to change that:

> "Participation in the HR Outlook Panel gives me and other panel members an opportunity to talk directly to our associates who are HR practitioners (because we know from phone calls each year how extensively this report is read).
>
> "I do not believe most senior managements including many CEOs, COOs and division presidents realize the extent to which the quality of our work force is becoming a limiting factor. They hear about it, but not very often from their own staffs (who don't like to be seen as making excuses and 'being negative'). They don't directly experience it. Our best-trained, best-prepared, best-behaved employees are the only ones who get assigned to the boss' office or to his immediate staff executives. The boss will have the hi-potentials paraded in front of him. Unless the boss does a lot of undirected wandering around and spends considerable time poking inside a department, some of these issues will go unobserved as they manifest themselves. People we didn't hire (and jobs we left unfilled because qualified candidates were not available) are invisible. Top executives will not see the unpromotable employees with limited skills.
>
> "HR practitioners have to surface this resource issue in ways that are vivid and meaningful to our top management in order to gain enough attention. We have got to get these concerns on the agenda because they can dramatically affect the strategic programs and directions charted at the top of the organization."

Government Regulation of Human Resources

In order to assess the burden of government intervention on management, the panel was asked which particular regulation, rule or law should be dismantled. From their answers it is possible to generalize: it is the bureaucratic detail, the compliance formality that is most burdensome. Some of these regulations are troublesome because they were designed decades ago to repair situations that no longer exist. Some petty formalities have grown like weeds, covering the field and raising costs without any benefit to the public or to business. Some laws dealing with union-management relations are of nugatory effect in the participative work environment of the 1990s.

The sum total of all responses, however, suggests that government intervention in the basic functioning of the labor market is not, in the United States, a serious problem.

> "In general, U.S. society has less regulation than virtually any other nation. The only area of which I am aware, where U.S. regulation exceeds others, is in discrimination issues. This, I believe, is the result of the massive diversity of our work force as compared with others." (Mitchell Fromstein)

Gene Remoff suggested that local and state regulation is a problem, and that the real problem at the federal level is a political desire to have business, rather than the public treasury, fund social programs:

> "State and municipal laws, which have proliferated in a number of areas impacting human resource management, are presently much more problematic for any corporation that operates nationwide and even regionally. Three problem areas are drug testing, state mandates regarding workers' compensation, and health care plans. The potential for broadly effective and efficient approaches is being overwhelmed by statutes that have been created with support from influential interest groups. The recent rash of state restrictions on managed care is an example of such a crazy-patchwork inhibitor. It is largely driven by health care providers who see managed care as a threat to their economic self-interest.
>
> "I am afraid we in the business community (or our less enlightened predecessors) brought most of the federal regulation on ourselves. Principal labor laws and rulings were often responses to brutalizing or arrogantly imperial management practices. Similarly, Title VII of the Civil Rights Act, Employment Retirement Income Security Act of 1974 (ERISA), plant closing regulations, and other legislation can be traced to highly visible and sometimes pervasive exploitation by certain corporations. Of course some of those laws remaining on the books seem irrelevant in light of present-day management practices and principles that have been elevated

> way beyond the standards that were introduced to protect public interest.
>
> "If we have a concern at the federal level it should be with the recently surfaced strategy of an election-driven Congress; a Congress seemingly impotent in re-ordering our national spending priorities, straightening out our tax system and re-defining where such tax revenues should be returned to the public. That strategy is manifested in a penchant for mandating human and social services on employers with an almost swashbuckling 'cost-be-damned' attitude. Politically, that is a fairly safe route for the Senator or Congressperson. But constantly looking in that direction to solve problems can be disastrous to the competitive ability of our businesses, large and small, particularly in markets that invite global competition."

Remoff has taken a street-level view of legislative impulse, one that suggests the powerful influences of special interests, public anger about corporate irresponsibility, and lawmakers' need to palm off social costs on enterprise. There is also the coolly rational view of legislative activity. David Lewin suggested that all regulations dealing with human resources be reviewed comprehensively in one package:

> "To begin to address reforms in this area, we must conceive of labor/human resource regulation as a large system or portfolio within which trade-offs can be made.
>
> "What we do now and have done for most of this century is to treat each regulation in isolation (e.g., immigration, labor relations, fair labor standards, discrimination, workers' compensation, pensions). What I propose be done instead is to lump all these regulations under the label of 'portfolio,' as we sometimes do in the area of tax law. Consider, for example, how reductions of overtime pay premiums could be used, in part, to finance a new system of national health insurance. Or consider how private pension systems could be better integrated with public pension systems as well as leave policies, portable health care provisions, and so on. The toughest question in this area is how to get a system or portfolio approach on the legislative agenda of the Congress and state legislatures. Perhaps its time for The Conference Board to publish (or commission) a special report on 'Regulating Labor/Human Resources in the U.S.: A Portfolio Approach to a Competitive Problem.' "

This lofty view may insufficiently cover the tiny details of regulation—those small pebbles that make the shoe fit badly and hurt. Four of the panel members suggested that such details need to be changed:

> "I would pray that a body of wise persons could revisit the entire compliance apparatus created around ERISA. The costs associated with all aspects of the specific compliance requirements, and the complexity of maintaining the qualified status of benefit plans, are excessive, particularly for smaller businesses, and surely serve as a deterrent to many of these firms when they consider providing benefits for their employees. They also provide a grazing ground for a secondary industry of lawyers, consultants, and software packages, adding to costs but not to benefits. Obviously, public regulation is required because tax-favored status is conferred, but the wit of man should be able to accomplish appropriate oversight without such a bewildering array of compliance reporting requirements." (Rex Adams)
>
> "We would like to see Section 414(n) of the Treasury regulations abandoned. It purports to assure that pension benefits are provided to people who are borderline employees of a company (i.e., they are employed and paid by third parties and used by a company on a continuing basis as contingent workers). The provision has had the effect of reducing the number of contingent workers used at various work sites but has not provided permanent jobs in exchange. The regulations use the threat of taxation to prohibit various practices instead of addressing the real problem and legislating the use of contingent workers as many other countries do. It requires costly record-keeping and premature termination of work assignments and it prohibits flexibility on the part of employers and employees." (Mitchell Fromstein)
>
> "The provisions of Federal Employers Liability Act of 1908 (FELA) apply almost exclusively to railroads and result in far greater costs than workers' compensation. But our real problem with the Act is the adversarial relationship that it automatically inserts in the employer-employee relationship. Moreover, because it ultimately relies on litigation to produce a result, it puts injured employees at risk as to the amount of compensation, if any, they will receive in any particular situation. In short, it's not fair, it's not effective, and it's not constructive.
>
> "The special disability provisions of the Railroad Retirement Act provide a narrow basis of possible re-employment, which facilitates the granting of a disability claim even though the employee would be capable of performing constructive work. In effect, it makes it easy for some employees to receive income for choosing not to work. At the same time, the Americans with Disabilities Act (ADA) will require employers to make accommodations for those who are disabled but who do want to work. In these two statutes, public policy is clearly going in opposite directions with the employer at risk in both." (Richard Sullivan)
>
> "The manner in which ADA is administered should be watched carefully. This truly enlightened legislation could turn into a nightmare if knowledgeable people of compassion and common sense aren't at the helm delivering fair determinations on reasonable accommodation.
>
> "Non-discrimination provisions of such benefits as 401(k) savings plans which include part-time workers in the formula are unwieldy. There is no purpose in a coun-

> try which should encourage those who can to save—and not penalize savers because others can't or won't save.
>
> "Immigration Reform (where the I-9 form administered upon employment turns personnel people into immigration agents) is not working.
>
> "Current wage and hour law regarding compensatory time is archaic. Requiring compensatory time off to be taken within the same pay period that the overtime is worked flies in the face of today's employee interests." (Madelyn Jennings)

One of the regulations that seems most out-of-date is labor law—almost 60 years old—which deters the creation of employee participation groups. The rationale for prohibition was that companies would create and control "sham" unions in order to keep out independent labor organizers. However, in the past decade or two, employers are likely to be much more interested in raising the level of participative teamwork than fending off unionism. Roger Phillips described the current situation:

> "Section 8(a)(2) of the National Labor Relations Act has been used by bureaucrats to discourage the use of employee participation committees in non-union organizations. The National Labor Relations Board (NLRB) has determined that an employee committee is a labor organization when it deals with or is formed for the purpose of dealing with the employer over terms and conditions of employment. This would cover any activity in the workplace. Today in North America there is a strong tendency to eliminate first-line supervision and bring the decision-making activity down to the lowest level of the organization. Based on increasingly competitive business conditions, all employers will have to increase their consultation with employees through the most effective process—the committee. The NLRB seems to be telling us that except in circumstances where employees choose to be members of the Teamsters, Steelworkers, Auto Workers, or the like, they should not be allowed to participate in the decision-making process as it affects their workplace."

Interestingly, unions are maintaining (in current hearings convened to consider a change in NLRB traditions) that the old threat continues, and that if any worker participation is desired it has got to be done through union organizations. David Lewin wondered whether unions are really in favor of employee freedom of choice. Ted Westerman commented on union thinking:

> "Worker-management cooperation groups have become a natural outgrowth of teaming efforts that are growing through many high-tech businesses. Requirements for productivity increases (which lie in the creativity and common sense of the employee doing the work) have led toward the creation of "teams" where the supervisor effectively becomes a facilitator and communicator.
>
> "In companies where the relationship between the people doing the work and the leadership is not continuously strained, the creation of employee-management work teams offers very little threat of sham unionism. Where the relationship is not good, the likelihood is, of course, much greater. The cliche that businesses get the unions they deserve was never more true. However, unions have contributed to their own demise through their lack of foresight and penchant to fight the last war."

Health Care

The panel achieved consensus on some limited areas in health care, and then began to fragment as the discussion grew specific. However, it is clear that management thinking has moved beyond the straightforward consideration of techniques for cutting or shifting costs of benefit plans. Public policy is now on the agenda.

There was a complete consensus that health care is a prime voter concern for the 1992 election year. However, the panel also agreed that there will be no resolution, no comprehensive reform in the next year. Two panel members felt that a direction "toward" a national solution will emerge this year, because the election has begun to look like a plebiscite on health care; and one member added, "perhaps on the matter of access."

A more wobbly consensus was achieved in a kind of broken run toward the goal line: single-payer proposals are not going to go away, and they will be more and more seriously considered—unless something better comes along. Finally, the panel thought that one of the biggest (but solvable) problems is access to care, or "continuation" of access. No wonder Congress and the administration seem to be stymied.

Providing a Canadian perspective, Roger Phillips said:

> "Yes, health and health coverage is a political issue and one which will not go away. In Canada where conservatives fought the introduction of universal health care in the 1960s, no politician of any stripe would dare to suggest major changes today. I predict the same concern for health will grip U.S. voters, especially employees of small firms where there are not enough employees to average down risks and where, should someone contract a disease which is costly to treat, the employer cannot afford to continue the coverage."

Rex Adams described some of the interest groups involved, but his overall view suggests we have reached an impasse:

> "Employers who provide coverage for their employees want cost shifting stopped but otherwise do not regard the problem as 'their problem.' Insurance underwriters are tenacious in defense of the principle of risk-rating premiums. Health care providers want an end to the hassle of trying to shift the cost of uncompensated care.

> "And yet, the conscience of the country remains troubled by the notion that millions of working people who are struggling to make ends meet in low-wage jobs effectively lack access to health care for themselves and their families. This is a political issue centered on access, but it is expanding in ever-widening circles to call into question the continued viability of the U.S. system of decentralized, employment-based health care.
>
> "In the meantime, employers will continue to pursue current strategies designed to shift part of the cost of medical insurance to their employees while concurrently embracing various cost containment initiatives such as managed care, utilization reviews, case management and other measures of this sort. These strategies are having some effect, but do not provide a long-term solution since the savings they generate tend to adjust on a one-time basis and do not address the rate of inflation. Perhaps because of the growing realization of this fact, I sense an amazing shift in sentiment within the corporate sector toward a national health solution.
>
> "Speaking for my company, which is relatively capital intensive and has done a somewhat more significant job at cost control and cost shifting than other companies, we would not welcome a transference of this problem to the tax base. So, for our part, we will continue to soldier on along our present course."

Several statements edged toward accepting that some national system will eventuate. Ted Westerman, for example, felt that business management of the entire health care system could be improved:

> "I think the position that most of us in industry have taken (and will continue to take for the predictable future) against some sort of national health care is outdated. We are going to be best served if we take the lead in designing the program. We have demonstrated, during the '70s and the '80s, with cost out of control, that by plan redesign and provider relationships we can put the medical profession on a more cost-efficient basis while still permitting the innovation and creativity that occurred in health care technology.
>
> "The administrative overstructure of health care delivery systems is a clear opportunity for bringing about efficiencies. I wouldn't want to overstate how much we can improve cost effectiveness merely by slamming medical claims processing offices together. I think that there is an administrative dimension to the medical providers where the efficiencies, redundancies, and overutilization efforts could bear more fruit. Just the administrative issues having to do with malpractice insurance and the very heavy cost-shifting could be dealt with as a part of a business-developed approach to national health care."

Ted G. Westerman
Hughes Aircraft Company

David Lewin topped off his description of the reasons and path toward national health care with a proposal for "sunset" legislation that would end the experiment and allow redirection after a trial period:

> "As work force reductions continue, and as average employee tenure with a private employer continues to decrease, the population 'at risk' in terms of not having access to employer-provided health care plans will grow. This is why the political debate over this issue is growing and will grow further.
>
> "We are stumbling toward some type of universal health care coverage system. This may take the form of national health insurance, which I think it will, or it may take the form of one giant private system in which the role of private providers is coordinated so that each of them, in effect, has a piece of the action. The dominant issue will be which actors in this private-(like) system get which pieces of the health care pie.
>
> "One possibility is the enactment of 'sunset' legislation for universal health care coverage. The United States could experiment with, say, a five-year national health care coverage law. This would permit us to test out the effects—benefits and costs—of such a law over a multi-year period. At the least, it would permit us to stop depending on other countries' experiences with universal health care coverage to argue for and against the adoption of such a system in the United States. My proposal also has implications for the way in which we regulate human resources more broadly in the United States; I had more to say about this previously."
> (See "Government Regulation of Human Resources," p. 16.)

There was discussion of various proposals requiring all employers to offer some basic health insurance to their workers, often referred to as "mandatory" health insurance. Such measures superficially appear to eliminate public expenditure, but often must incorporate parts of the public systems, Medicare and Medicaid, to extend coverage to all. Also, employer-mandated health benefits do not deal clearly with the increasing mobility of workers. John Zimmerman explained:

> "We must recognize that this mandatory health coverage would still not address the unemployed, the unemployable, children and other dependents of covered employees who have no dependent coverage. It is at best

> a partial solution. Sooner or later we must face up to a national health policy. A free enterprise system of medical service delivery is just not efficient and is further reduced in effectiveness by cost shifting, duplication, malpractice insurance costs, and many other factors. It may result in another lousy bureaucracy but that would be better than the fragmentation and lack of control we have now. We have got to be protected from paying millions of dollars that do not deliver medical care."

Madelyn Jennings pointed out that Americans would resist the kind of rationing that other national systems contain. The existence of numerous public and private commissions and public-interest councils does not seem to have brought national consensus so far, perhaps because of the various private agendas of interested parties. Yet another try might be useful if it were not politicized:

> "The United States and South Africa are the only industrialized countries without a national health policy. The Government Accounting Office estimates $67 billion in savings (10 percent of total costs) in insurance company and government claims handlers if we had a health care system similar to Canada's. However, any move toward a Canadian or British system would require a major re-education of our people. They have grown up expecting instant access to health care. The possibility of health care rationing is totally foreign. Providing this re-education would certainly be a challenge.
>
> "Consider the interests—providers, hospital and physicians, insurance industry, various size employers, employees in general, government. Each group has its own agenda. And the physicians have backward incentives for efficiency. They must do more things to people, or charge more, to increase their own income.
>
> "The current dozen or so pieces of proposed federal legislation are feeble attempts. Is there a way to bind us together for the national good through some blue ribbon panel or commission representing all the interests agreeing to abide by such a commission's recommendations? This might be a start toward breaking the impasse."

Dan Mitchell has given up on this idea, claiming that a piecemeal (perhaps "helter-skelter") approach will prevail because it is the American way:

> "Note that one thing that health administrators in our decentralized system try to do (rationally) is to push costs to someone else's program (e.g., workers' compensation, spouse's insurance, Medicare). But at the national level this is a zero-sum game; it doesn't reduce costs. Rather, it reshuffles them.
>
> "The American solution will be something that uses the existing private providers (thus buying them off). However, it will attempt to coordinate providers in the aggregate as if they comprised a single national plan. This means no rejected coverage due to pre-existing illnesses, fees for coverage based on national experience (not company experience), and financial transfers between carriers to compensate those who happen to end up with high risks.
>
> "We will probably stumble into each of these features one by one rather than design the whole thing at once. Decentralized stumbling and a piecemeal approach is the American way.
>
> "You can see the ground shifting already. Look at the recent switch by the American Medical Association toward a favorable approach to some kind of new national plan. All the players will begin jockeying for position as the debate unfolds. Again, this is the American way."

Employee Transiency vs. Common Purpose

Human resource management used to concern itself with a stable group of workers, augmented at a carefully measured pace by new recruits, by retirements and some terminations for cause.

However, transiency throughout the corporate work force has become commonplace as a result of competitive conditions. Major downsizings, terminations and early retirements continue to undercut former job security. Subcontracting, employee leasing, temporary and other contingent work arrangements create a more remote, arms-length relationship between management and employees. In addition, various pressures on benefits seem to be driving employees and managers toward individual self-responsibility and away from connecting bonds with the company.

What happens to teamwork, formal structure, and common purpose in a corporation so centrifugally affected? What happens to standards ("the way we do things around here") when there is no remaining sense of "we"? Rex Adams offered the first answer:

> "This is a good question. I have been struck by the degree to which major companies are struggling with precisely this set of issues. People talk about TQM projects, consultancy skills, organizational development interventions and related matters. These initiatives all stem, in large measure, from the perceived need to find new ways to set standards, motivate performance, gain allegiance; the need to find new paradigms for organizational effectiveness in the aftermath of having effectively destroyed the former paradigm based on a sense of community.
>
> "I sense there is a new maturity and a new realism in industrial organizations today. Yes, the old contract has been broken. Yes, there is a compelling need to find new drivers of organizational performance to replace traditional expectations and incentives. But what most impresses me is the degree to which most companies are effectively addressing the problems, and the positive

> response most of us are getting from our employees. The motivation comes from the desire of autonomous individuals to perform at their capacity and to be rewarded according to their performance, as well as their insistence on full communications of expectations and shared responsibility for outcomes. This is a better, more realistic world."

Most of the panel members considered the job of involving employees in decision-making as primarily a human resource concern. However, corporate executive levels also seem to view employees as a single group. David Lewin does not see the situation that way:

> "What of the concern that new organizational and work force churning—downsizing, vendoring, contingency arrangements—will weaken the common purpose of business enterprises? I don't buy it because I believe that this common purpose has been widely overstated.
>
> "Most businesses have a common purpose among a few high-level managers and executives, far less so among other organizational members. Recall that stability and security—of customers, managers, and employees—have been most closely associated with monopolies and oligopolies, not competitive organizations. Enhanced competition thus implies more organizational and work force churning—instability. The question becomes how best to adjust to such new churning.
>
> "The lesson is that employee involvement/participation applies to some organizational members, the core—and not to others, the periphery. In this sense, some instability of employment seems to serve the purposes of virtually all businesses."

The general consensus was that transiency in the work force is beneficial, or at least that it is not creating extreme problems. Several descriptions of the change are quite upbeat.

> "Some of the standards (the way we do things around here) need new and continuing scrutiny and change; many of those standards are what contributed mightily to the need for downsizings, terminations, and early retirement programs. But the centrifuge of change can be accompanied by the cohesion of the central core. And while I can't explain that in the sense of physics, I believe that is the real stuff of the management task.
>
> "There is no doubt that the concept of job security has been undermined and that the 'we' factor in corporate organizations could be jeopardized. The only antidote is continuing open and candid communication about the status of the enterprise, the requirements of the customers, and the vision of the necessary elements for future success. Organizations and individuals with illusions about job security are going to hurt themselves; those with an accurate understanding of job security probably also have a good picture of what needs to be done to achieve it." (Richard Sullivan)
>
> "In my view many corporations during the good old days didn't have the teamwork and common purpose that now is lamented as lost. If they did, the boss, whether right or wrong, called the shots; some employees dutifully responded, others voluntarily left for greener pastures, or—if they were low enough on the hierarchical ladder—did what they had to do to get by and still live with themselves.
>
> "There are many companies that were not facing Chapter 11 or 7 that have downsized, reduced staffs and layers through terminations and earlier retirement window plans, subcontracted, hired contingent workers, etc.…with the purpose of becoming more competitive and more effective. And guess what, they have succeeded in achieving that desired result.
>
> "Now let's look at those who remain in a restructured organization. They discover, quite often, that there is clearer focus and understanding of organizational purpose, more explicit communications on what good performance is supposed to look like, less layers of managers who review and approve what they do, less staff reports, analysts and meetings, and more encouragement to do what it takes to serve the client or customer. In general, an uplifting of organizational vitality. And if that's not all, the happily missing old stuff is being replaced by true work teams, boss-subordinate dialogue and agreement on common purpose, and a general increase in employee identification with and power over the work they do and how they do it. Managements are even getting better at acknowledging where they need to be directive in their leadership practices.
>
> "Something else is happening that could have a significant impact on how people view and identify with their employer and the employer's product or service offering—and how managements may come to view their work forces and organization structures. It is the emerging phenomena of strategic alliances also referred to as strategic partnerships. These are relationships between two or more firms established to present a certain product or service package to a particular target customer or market." (Gene Remoff)
>
> "Both corporate managements and their work forces are undergoing one of the most profound transitions in our nation's history. The need for change is a result of excesses which were practiced in a sort of vacuum in the '70s and '80s. Expectations were driven to an unreasonably high level and costs rose dramatically in the absence of a price-competitive marketplace. The situation today requires a retreat from that environment in all functions and at all levels. The downsizings, outsourcings and contingencies are short-term adjustments which will, in my opinion, eventually give way to the need for teamwork, common purpose and formal structure. The typical core work force will be lean and well-protected and will have standards, structure and purpose. They will be supported by flexible elements.

> Isn't that the Japanese way, which has been so widely respected and successful? The problems today are those of witnessing the transitional adjustments without seeing the final results. I am optimistic." (Mitchell Fromstein)

The theme of optimism, of course, arises out of human resource executives' jobs. They do not like downsizing, they like developing working groups. The core of an HR job is development and training. Alan Ewalt expressed this HR viewpoint clearly:

> "One of the stimulating aspects of organizational behavior is the resilience after an organization 'downsizes.' Many do, in fact, come out stronger. The organization heals itself from the surgery and pulls together to fight for its survival. New work teams emerge and a new spirit or standard can emerge. The emergence of new standards may be just what was needed to turn the course for a business, to make it more competitive. The organization will learn the new behaviors required. Commitment must be rebuilt, and the extent to which this is done will largely dictate the eventual success of the change.
>
> "People are generally highly adjustable. The more change they are accustomed to, the more likely that they will take to another change quickly (e.g., the more workers are accustomed to continual improvement, the more likely they'll be to embrace a new, improved method)."

In the midst of this U.S. culture of employee development, Mexican cultures seem wildly different. Yet they, too, are undergoing change because of exposure to competition and "new ways." On the other hand, Luis Porfirio Diaz does not indicate rapid adjustments in his description of changed circumstances:

> "Mexican approaches to human resource management are related to two major historical tendencies. On the one hand, there are the native and Spanish paternalistic styles—meaning the boss is the more rational part of the relationship between authority and subordinates. On the other hand, there are autocratic and efficiency-technocratic values imported alongside with recent modernization of the country. These are still conceived as foreign implantations of alien organization cultures.
>
> "Financial institutions are among the more retarded and conservative entities in human resource management. They still lack innovative leadership. For years to come, founder families will collide with institutional and professional managers supported by mergers with foreign parties. The family founder culture is predominant and castrates opportunities for developing real managerial generations."

Madelyn Jennings returned to practicalities: What do employees expect of their company, however short-term the relationship may be?

> "The new employees want training, developmental opportunities, recognition, and the feeling of being 'inside the ropes' by knowing what's going on as it affects their company and them. They also expect nurturing and flexibility—in scheduling, in personal time, in job structure.
>
> "The corporation that is tuned in to these expectations will not necessarily have a less productive work force. It just may not be as long-term a work force. The bonds that tie teams and common challenges together are *very* powerful. Even the older loyal employee was driven by some of the same aspirations as the new employee...to grow, to make more money, to be recognized as an achiever. The work force may be less stable, but it may be every bit or more of a contributor to the organization.
>
> "People may play on different teams throughout their career, but that doesn't mean they'll play less hard or with less commitment than if they only signed with one team."

John Zimmerman summed up the needs of 1992 and beyond:

> "Change is clearly the operative word in describing the relationship between employers and employees in today's work environment. This relationship must be constantly evaluated and redefined. There was a time, less than 20 years ago, when it was a simple equation. The employers gave security and the employee gave loyalty. The evolution of yesterday's work environment to today's work environment has brought about a very significant change in the definition of this relationship. Today loyalty is not exchanged for security; it is far more complex. The employer is asked to provide openness and information, fairness and truth, and opportunity for a meaningful career. The employee is asked to provide contribution and productivity as well as skill and competence resulting from self-development.
>
> "As we look at this new, constantly changing workplace paradigm, we need to identify keys to success. First, there must be a greater awareness of common purpose and how corporate objectives are interrelated with individual objectives. Second, there must be a strong definition of fundamentals or bedrocks. Change is clearly guided and fostered by what doesn't change."

The objectives of employee management have been shifting rapidly in recent years, augmenting rather than transforming the task of human resource executive. Recently, cost-cutting pressures have made it seem that terminating employees, reducing benefits, contracting work out, and sloughing off divisions and departments are the dominant activities. The panel senses that this pressure will continue, but they are ready to get on with the job in good spirit.

Human resource officers also sense that they are responsible, more than others, for the long-term future of their businesses. Rex Adams said:

"Fundamentally, the human resource role is to maintain organizational integrity over the long term, because the operating people are acting in the *very* short term, milking the company of its own future and leaving the problems for successor managers."

The "long term" means assuring that the present and future productive capacity of the business is not impaired by cost cutting. It also means maintaining flexibility and adaptability among the entire work force, including managers. It means building morale at a time of economic stagnation, and fostering teamwork when individuals feel more alone and "at risk" than ever before.

In other words, it is a tough job.

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The Conference Board

Report Number 986

Corporate Ethics Practices

An international survey of ethics codes and programs reveals:

- *nearly half of all company codes written since 1987*
- *HR and legal departments more involved in code drafting*
- *emphasis on environmental statements increasing*
- *new ethics training programs started for middle managers*

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About The Conference Board

Founded in 1916, The Conference Board's twofold purpose is to improve the business enterprise system and to enhance the contribution of business to society.

To accomplish this, The Conference Board strives to be the leading global business membership organization that enables senior executives from all industries to explore and exchange ideas of impact on business policy and practices. To support this activity, The Conference Board provides a variety of forums and a professionally managed research program that identifies and reports objectively on key areas of changing management concern, opportunity and action.

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Corporate Ethics Practices

by Ronald E. Berenbeim

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About the Author

Ronald E. Berenbeim is a senior research associate in The Conference Board's Business/Education program. He is the author of 16 Board research publications and many magazine and journal articles on corporate ethics, intellectual property safeguards, employee privacy and global business organization. From 1977-88 he served as a director of Guaranty National Corporation. He is a graduate of Cornell University, Balliol College, Oxford (Keasbey Scholarship), and Harvard Law School. Mr. Berenbeim is currently an adjunct professor at New York University where he teaches business ethics.

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The author thanks Laura Nash, ~~The Institute for the~~ Study of Economic Culture, Boston University, for her help in designing the questionnaire and for many useful comments. The author also thanks Andrew Tank of The Conference Board Europe and John Longair of The Conference Board of Canada for their assistance in obtaining European and Canadian participation.

From the President

Company programs developed to define the organization's basic ethical principles and to increase employee sensitivity to ethical issues have become more sophisticated and ambitious since The Conference Board's first examination of this subject in 1987. Efforts to formulate environmental responsibility statements and ethics discussion groups for middle managers are two examples of the expanded scope of corporate ethics initiatives.

This report expands the scope of the Board's 1987 study and provides three new case studies to illustrate how senior executives respond to practical situations that pose ethical dilemmas.

We are grateful to the executives in the United States, Canada, Europe and Mexico who responded to this detailed survey and to the senior executives who were interviewed for this study.

PRESTON TOWNLEY
President and CEO

Method

A total of 264 companies (186 U.S., 40 European, 34 Canadian, and 4 Mexican) responded to The Conference Board's survey of 1,900 firms. The median sales figure for these participants was $1 billion. Respondents to the questionnaire included CEOs, general counsels, senior human resource and financial executives, and auditors. Further interviews and discussions with The Conference Board's European Council of Bank Chief Financial Officers and its European Council on Quality provided additional insight and perspective.

Responding Companies (N=264)

Dominant Business	*Number*	*Percentage**
Manufacturer of:		
Nonconsumer products	58	22
Consumer durables	16	6
Consumer nondurables	31	12
Financial:		
Banks	31	12
Insurance/Financial services	27	10
Retail trade	8	3
Construction	2	1
Extraction	8	3
Utilities	25	9
Transportation	8	3
Broadcasting/Publishing	4	2
Restaurants/Lodging/ Entertainment	1	—
Advertising/Accounting/ Consulting	4	2
Health Care	2	1
Other	34	13
No answer	5	2

* *Because of rounding, percentage does not always add up to 100.*

A Note on Europe

The European sample includes companies from many countries. In time, with more participants from Europe, it may be possible to discuss the contrasts between responding groups from different European countries. Although some data on U.K. practices have been provided by another source, The Conference Board's sample is not large enough for extended analysis. It is worth noting that relatively few differences in practice and opinion existed between U.S., Canadian and European companies, so that analysis of practices within specific European countries, while desirable, may not be necessary.

Executive Summary

This study is designed to supplement the 1987 Conference Board study, *Corporate Ethics*. It seeks to answer many of the questions raised by the earlier report on efforts to formulate, disseminate and inculcate a company's ethical principles through the enactment of corporate ethics codes and the sponsorship of ethics training programs.

Corporate Ethics Practices reports on the prevalence of specific kinds of company ethics statements and the issues and policies they address. It discusses code revision and distribution procedures, examines board of directors ethics committees, and documents trends in company-sponsored ethics training programs. For possible use in ethics discussion groups, three new case studies and participant responses to these hypothetical examples are included. A further objective of this study, to improve the 1987 non-U.S. participation rate of 16 percent, was achieved — non-U.S. firms constitute 30 percent of this sample.

In contrast with the 1987 study's reliance on CEOs, this report also includes the views of senior human resource and finance executives, general counsels, and auditors. The greater involvement of functional department heads and the general counsel suggests that in many organizations, code formulation and ethics training programs have moved beyond the initial phase of CEO sponsorship and are now institutionalized responsibilities for certain senior executives.

The CEO remains the company's chief spokesperson on ethical issues. Nearly one-third of the responding companies (31 percent) said their CEO had issued a personal statement or formal discussion of ethics issues in 1991. The increase in CEO ethics pronouncements was particularly noteworthy in Europe (40 percent); according to some 1987 European study participants, company officials were said to be reluctant to engage in public discussion of business ethics.

Codes and Ethics Statements

Code drafting is an ongoing process — nearly half (45 percent) of the survey respondents that provided data on code adoption said they had enacted their statement since the last study was published in 1987. Codes continue to be less popular among European respondents (50 percent) and financial organizations (57 percent).

Those companies that do have ethics statements are now more willing to discuss them openly. In 1987, only a handful of respondents returned a copy of their code with a completed questionnaire. In 1991, more than one-third of the companies with ethics statements supplied them with their surveys.

These documents utilize one of three basic formats (most combine more than one of these approaches):

- Compliance codes — directive statements giving guidance and prohibiting certain kinds of conduct.
- Corporate credos — broad general statements of corporate commitments to constituencies, values and objectives.
- Management philosophy statements — formal enunciations of the company or CEO's way of doing business.

Compliance documents are the most common; 90 percent of the code companies say their statement enjoins particular kinds of employee or company behavior. Three-fourths said their code contained a credo and over half (57 percent) answered that their statement included declarations of management's business philosophy.

Content of Individual Codes

Most ethics codes (88 percent) include some statement of the company's fundamental principles. Of the nine most frequently cited specific issues in company codes, six relate in some degree to the employee's contract with the company. Purchasing guidelines (56 percent) and security of proprietary information (53 percent) — issues focused on employee honesty — were the only specific areas of concern cited by over half of the code companies.

Three subjects outside the employer-employee contract often included in ethics statements relate to corporate social accountability — environmental, marketing, and product safety responsibility. From 1987 to 1991, other than a new or revised formulation of guiding principles, environmental concern was the most popular subject of provisions added to company codes.

Consistent with the subject matter of these documents, senior human resource executives and the general counsel's office have played a major role in the drafting and preparation of the company's ethics statements. Survey participants of the 1991 study reported much higher involvement of boards of directors and general counsels than was noted by 1987 respondents. (The earlier questionnaire did not ask about human resource participation.)

A clear trend in favor of distributing the company's code to all employees emerged among 1991 survey participants — 77 percent follow this practice, an increase over the nearly two-thirds who said they did so in 1987.

Ethics Training Programs

Almost one-fourth of the companies have sponsored new ethics training programs, ethics committees, or ombudsperson's offices since 1987. Among companies with codes, the percentage is nearly one-third because these undertakings are rare in companies without ethics statements. Such programs are less common in Europe and Canada than in the United States.

Study groups for middle managers was the most popular program initiative. Video productions and, in a few cases, board games were used in ethics discussion groups. Most training projects utilized materials developed in-house, and relied on company executives as facilitators.

Board of Directors Ethics Committees

About 10 percent of the boards of directors in the sample have an ethics committee. This practice is less common in Europe; only two European companies had ethics committees and they consisted solely of inside directors. In the United States and Canada there is a slight preference for a mix of inside and outside directors (13 companies) over limiting appointments to outside directors (nine companies). In the United States, the committee chairman is almost always an outside director (two exceptions), whereas the Canadian respondents with ethics committees were evenly divided (i.e., two have company board committees chaired by an inside director and two are headed by an outside director).

Current Practices in Corporate Ethics

The profile of participating companies suggests that corporate efforts to establish ethical accountability and to improve sensitivity to ethical issues have advanced considerably in sophistication. The degree of commitment that such programs appear to receive from top management has also increased. Whereas the CEO was the primary source of information for The Conference Board's 1987 study — within the United States — particularly among larger companies, senior human resource executives and the general counsel's office provided much of the data for this one. Outside the United States the CEO was more likely to respond to the survey on behalf of the company.

Key Developments in Corporate Ethics Practices

In all three regions, many CEOs are now commenting openly and often on business ethics. Eighty-three companies (31 percent) said that their CEO had issued a personal statement or formal discussion of ethics issues during the past year. The percentage of European company CEOs that spoke publicly on ethics was actually higher (40 percent) than the figure for U.S. respondents (36 percent). Canadian CEOs were much less likely to engage in this practice (12 percent). The frequency with which European CEOs have addressed ethics issues might be surprising to those European participants in the 1987 study who believed that European business leaders were, on the whole, more reticent than Americans on this subject.[1]

Code drafting is an ongoing process — nearly half (45 percent) of the codes discussed or submitted by survey respondents have been enacted since the last study was published. (For a discussion of the reasons for new and amended codes, see "Codes of Ethics and Training Programs," p. 11).

Codes have also become public documents. In 1987, only a handful of companies responded to the Board's request for copies of ethics statements. More than one-third (37 percent) of the companies that had codes returned the document with the current survey.

Elaine M. Martin, senior attorney, IBM, U.S. Operations, explained her company's attitude with respect to sharing its code: "IBM has had a long standing policy of making its code available to other companies. The problems that our statement addresses are not unique to the company or to the industry. However, there is currently much greater interest in ethics throughout the entire business community and everyone is trying to address the same problems and issues: How do you get management support for codes and programs? How do you implement these policies and initiatives? We think there is great value in sharing what we know and in receiving codes from companies that are also serious about addressing these questions."

Greater Senior Management Concern With Ethics

In many organizations, code formulation and ethics programs have moved beyond the initial phase of CEO sponsorship and are now part of regular departmental responsibilities — particularly in human resources and the company's legal office.

The increased interest and involvement of senior executives in the creation of ethics policies and programs is due in large measure to greater emphasis on four areas of corporate concern:

Global management issues. Companies that are new to the global marketplace, as well as those that have been active in foreign markets for many years, want to determine their company's "core" values while simultaneously showing respect for local customs and practices. Striking a balance between these competing requirements is not always easy. Survey participants also referred to three different kinds of external pressures within the international community that can further complicate a company's efforts to reconcile its core principles with local business practices: (1) industry standards of behavior; (2) demand for support of movement for social or political change (e.g., Sullivan principles); and (3) conventions or regulations promulgated by world or regional multinational organizations (e.g., protections for intellectual property).[2]

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[1] Ronald E. Berenbeim, *Corporate Ethics*, Report No. 900, The Conference Board, 1987, p. 13.

Total quality management (TQM). A successful TQM program is one in which the company defines relationships of trust with employees, customers, suppliers and local communities. The written codification of principles of accountability to these constituencies is a popular format for corporate ethics statements (see "Codes of Ethics and Training Programs," p. 11).[3]

In addition, the team structures utilized by TQM require a core of shared commitments and values to develop and to achieve high standards of production. Emphasis on cross-training and personal autonomy affirm the view of the workplace as an environment for the personal development of the company's leaders, managers, production and service workers.

Work force diversity. Along with representatives from the general counsel's office, senior human resource executives are most likely to be involved in the formulation and implementation of ethics codes and programs. The high frequency of human resource participation is due, in large measure, to the prominence of human resource issues in ethics codes, or the need within the last three years to add or revise company statements on subjects such as workplace safety, proprietary information, and purchasing (see "Codes of Ethics and Training Programs," p. 11).

The increasing tendency of companies to define the employment contract with greater specificity is a response to increased work force diversity, and the significant downsizing of corporate departments. New and less experienced workers and managers are now responsible for decisions, and the maintenance of key customer or supplier contacts previously delegated to employees with well-established records of service to the organization. These duties were once assumed within the context of a long-term commitment between employer and employee. Since the present competitive environment does not give companies the option of maintaining staffs or offering job security characteristic of pre-1980s companies, no real alternative to increasing the ethical literacy of all employees is available.

For senior executives and managers, the emerging employer-employee relationship emphasizes fair rules and opportunities rather than employment security; it treats employees as people who are embarked on a career rather than an extended period of service to the company.[4]

To some degree, the popularity of regional and national associations for workers with major responsibilities, in areas such as human resources and auditing, is a response to the changing employment contract. Many of these organizations have promulgated codes that define the requirements of professional accountability. In essence, these corporate statements are one vehicle companies use to develop their own standards of managerial responsibility.

Inadequate education and training. U.S. business leaders have expressed serious concern with the quality of public secondary education. The primary focus of this alarm has been on deficiencies in science, mathematics and literacy. However, an educational system that gets poor results in these areas cannot be expected to produce graduates with the analytic power and verbal and interpersonal skills needed to make and implement sound ethical decisions.[5]

---

[2] See Ronald E. Berenbeim, *Safeguarding Intellectual Property*, The Conference Board, Report No. 925, 1989.

[3] See Lawrence Schein, *The Road to Total Quality*, The Conference Board, Research Bulletin No. 239, 1990, pp. 6-7.

[4] See Dana E. Friedman, Arlene A. Johnson, *Strategies for Promoting a Work-Family Agenda*, The Conference Board, Report No. 973, 1991, p. 14; and Helen Dennis and Helen Axel, *Encouraging Employee Self-Management in Financial and Career Planning*, The Conference Board, Report No. 976, 1991.

[5] See Ronald E. Berenbeim, *Corporate Support of National Education Goals*, The Conference Board, Report No. 978, 1991; and Leonard Lund, *Literacy in the Work Force*, The Conference Board, Report No. 947, 1990.

Codes of Ethics and Training Programs

For most medium- to large-sized companies within the United States, and for a substantial but smaller percentage of non-U.S. organizations, a code of ethics or statement of accountability is the first step in stating the firm's ethical principles. Ethics discussion and training programs are often used to increase sensitivity to corporate responsibility issues raised as a result of the introduction and dissemination of company codes.[6]

Although data provided by questionnaire respondents indicate that nearly half (45 percent) of the ethics codes cited have been enacted since the 1987 Conference Board survey, these documents may have replaced existing statements. There is only a slight difference between the percentage of U.S. and European participating companies with ethics statements in 1987 and the proportion that categorized their organization as a code company in the current study (see Chart 1).

As was the case in the 1987 survey, financial firms (57 percent) were less likely to have codes than companies in other industries (82 percent).[7]

Within Europe, however, there is evidence of growing interest in codes among U.K. companies. In a 1991 survey conducted by the Institute for Business Ethics (London), 71 percent of the participants said that their organization had an ethics statement. In the Institute's 1987 survey, 55 percent of the respondents said they had codes.[8]

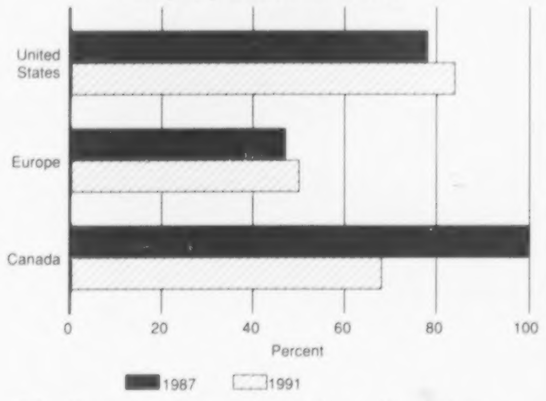
There is a significant difference among Canadian responses in the two studies. All 16 Canadian participants said they had codes in 1987 and only 68 percent (23 companies) noted that their company had an ethics statement in the 1991 questionnaire (see Chart 1). This finding may be due to the larger number of Canadian respondents in the 1991 survey.

In sum, within the regions and countries surveyed, company attention to ethics statements since 1987 has been characterized primarily by vigorous activity in rewriting and amending. However, other than possibly in the U.K., there is little evidence that many minds have changed in the ongoing debate on whether a company ought to have such a document in the first place.

Outside the U.S., Canada and Europe, there is growing Japanese interest in the importance of company standards of ethics and greater managerial "self-discipline." In an August 1991 survey, conducted by Keidanren (Japan Federation of Economic Organizations) in the wake of banking and securities scandals, 252 senior executives of member corporations (e.g., directors, committee and subcommittee chairmen) regarded well established internal standards of accountability and "self-discipline" (68 percent) as a more important check on potential company misconduct, than such external measures as "strengthening the functions

Chart 1:

Regional Prevalence of Company Codes of Ethics*



* Four Mexican responses are not included because Mexico did not participate in 1987, and this year's response was too low to draw meaningful conclusions about the prevalence of codes in Mexico.

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[6] Forty-four percent of the 1987 survey participants use ethics training programs to supplement their codes. See Ronald E. Berenbeim, *Corporate Ethics*, Report No. 900, The Conference Board, 1987, pp. 17-18.

[7] Berenbeim, *Corporate Ethics*, p. 14.

[8] Simon Webley, Business Ethics, Company Values and Codes: Current best practice in the United Kingdom, Institute of Business Ethics, to be released in March, 1992.

of shareholder meetings" (14 percent) and "making positive use of the system of outside directors (28 percent)." These Japanese senior executives also favored "improving intracompany auditing functions" (52 percent) and "better public disclosure" (42 percent) as effective practices and policies for improving corporate ethical performance.[9]

Why Companies Adopt Codes

Five reasons are often cited for adopting codes: (1) they generate discussion as to what constitutes ethical conduct in carrying out company business; (2) in turn, discussion helps achieve a consensus on appropriate behavior; (3) written enactment reinforces understanding of and commitment to company standards; (4) dissemination of statements communicates expectations and consequences for non-compliance; and (5) code drafting determines core principles applicable to the regions and industries in which the company is active.

Although there is considerable support for these views, particularly among U.S. business leaders, acceptance of this rationale for formulating company codes is far from universal. While 84 percent of the U.S. respondents have codes, only 58 percent of non-U.S. participants have them (see Chart 1).

Companies that do not publish their ethical principles often believe that such an exercise is unnecessary. Such companies feel that ethics statements and programs only duplicate practices and policies already in place. W.G. Byrnes, Head of Corporate External Affairs, Unilever PLC, while not discounting the contribution codes can make, argues that "a strongly ethical outlook and high ethical standards" are not necessarily derived from "the operation of a set of specialized formal procedures."

Citing the company's internal audit procedures and its strict product and workplace safety standards as examples of the company's "standards of integrity," Byrnes notes that the company does not have "a set of separate 'ethical' procedures superimposed upon the standards that we consider to be part of operational management practice."

A variant of this argument is that an organization's values are a product of its culture; therefore, codes have a limited impact on employee behavior — particularly in a company as old as Unilever: "We would regard decent standards of behavior — to employees, customers and society at large — as having much more to do with attitudes and culture than a superimposed administrative ethical framework."

This view is supported by research findings that written codes do not decrease the number of corporate violations of the law. Researcher M. Cash Mathews compared 202 manufacturing companies utilizing codes with 104 that did not have ethics statements. According to her findings, code organizations were just as likely to be convicted of illegal acts as those that did not have declarations of ethical principles.[10]

Code Formats

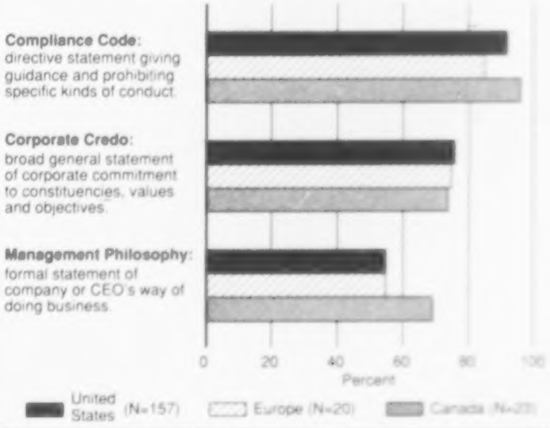
Codes furnished to The Conference Board in current and earlier surveys and requests utilize one of three basic formats (most codes combine more than one of these approaches):[11]

- Compliance codes: directive statements giving guidance and prohibiting certain kinds of conduct (see Exhibit 1, p. 32).
- *Corporate credos:* broad general statements of corporate commitments to constituencies, values and objectives (Exhibit 2, p. 34).
- *Management philosophy statements:* formal enunciations of the company or CEO's way of doing business (Exhibit 3, p. 35).

Among the 201 responding code companies, compliance codes are the most common format. Over 90 percent say that their company's statement enjoins particular kinds of employee or company behavior.

Three-fourths (151) of the participating code organizations say their statement is a credo that explicates the

Chart 2:
Formats Utilized in Ethics Statements
(200 code companies responding)



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[9] *Keidanren Review*, No. 131/October 1991, p. 4 (survey results have been rounded).

[10] For a discussion of the Mathews research and other arguments for and against codes, see Ronald E. Berenbeim "An Outbreak of Ethics," *Across the Board*, May, 1988, pp. 15-19.

[11] The 1987 survey followed earlier Conference Board requests for codes that date back to the 1970s. This collection of documents is known as the Watson Collection. Berenbeim, *Corporate Ethics*, p. 16.

company's accountability to its key constituencies (e.g., employees, customers, suppliers). Management philosophy declarations are the least common format; still, more than half (114) of the code companies have this type of statement, and Canadian firms are more likely to use them than are U.S. or European firms (see Chart 2).

Survey responses indicate most codes are hybrid versions of more than one format. Only 17 companies said their statement was limited to compliance directives, and no organization relies solely on a corporate credo or management philosophy format. Ninety-eight companies utilize all three approaches, and 31 have both a compliance code and a corporate credo. Other combinations are rare — compliance and management philosophy statements are favored by five companies, and only one respondent uses a credo and management philosophy approach.

While four participants said their company's statement was formulated prior to 1920, nearly half of the codes currently in use by survey participants (45 percent) — and for which the adoption date was provided — have been enacted since the Board's 1987 report.

Of the three statements, the compliance code is likely to have been in existence the longest. The median date of adoption for compliance statements is 1985. The median year for adopting credos was 1986. An organization's management philosophy statement is likely to be newer — over half of them have been enacted since 1987.

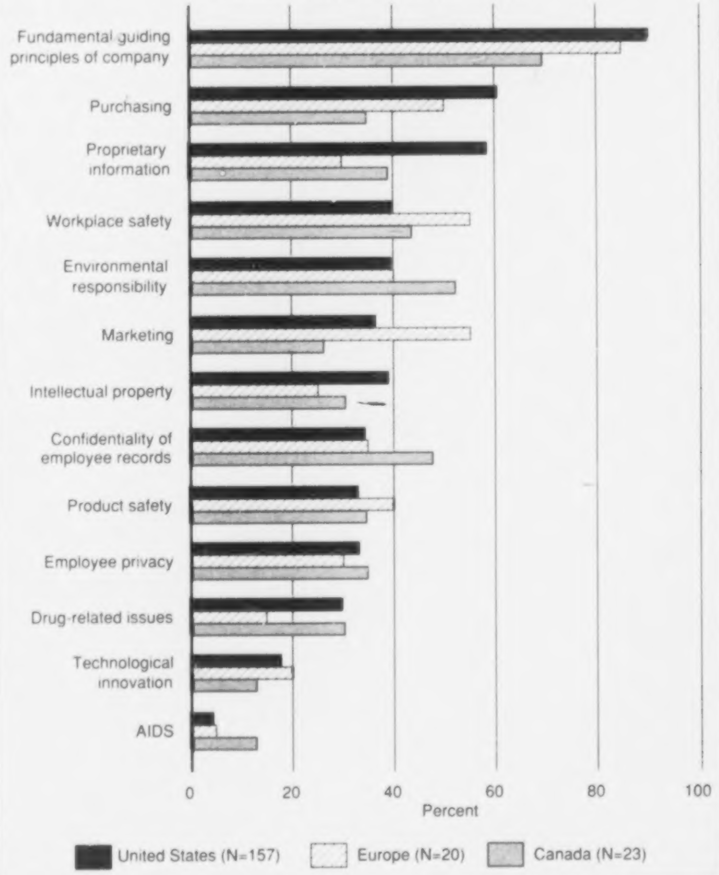
The 1987 report found that code drafting was "a dynamic process" — 56 percent of responding companies had amended their codes within three years prior to the 1991 survey.[12] The current survey responses showed an almost identical tendency to amend statements — 59 percent of the subject codes were changed within the three-year period prior to the survey; but companies were more likely to amend certain kinds of statements. Nearly two-thirds of the compliance codes had been revised, while slightly more than half of the management philosophy statements had been changed.

Content of Individual Codes

Study participants were asked to indicate which of 13 subjects were included in their ethics statements (see Chart 3). Most ethics documents (88 percent) include some formal statement of the company's fundamental principles. Nine specific issues in codes were named by more than 66 companies. Among these, six relate in some degree to the employee's contract with the company. The prevalence of such concerns virtually guarantees the heavy participation of human resource managers in the formulation, dissemination, assessment, and revision of company ethics statements and programs. Purchasing guidelines (56 percent) and security of proprietary information (53 percent) — issues focused on employee honesty — were the only specific areas of concern cited by over half the code companies.

Of the remaining human resource-oriented issues, three acknowledge company commitments to the employee (workplace safety, confidentiality of employee records and employee privacy [13]), and one focuses on

Chart 3:
Issues Addressed by Company Ethics Statements
(200 code companies responding)



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[12] Berenbeim, *Corporate Ethics*, p. 14.

[13] For a discussion of employee privacy issues, see Ronald E. Berenbeim, *Employee Privacy*, Report No. 945, The Conference Board, 1990.

employee obligations (intellectual property safeguards [14]). The three remaining major subjects relate to corporate social accountability — environmental, marketing, and product safety responsibility (see Chart 3).

There are few regional variations in subject matter. Codes in the U.S. are more likely to include sections on the security of proprietary information; workplace safety is a more frequent subject of European ethics statements; fundamental guiding principles are much less common in Canadian ethics statements, but policies regarding environmental responsibility and the confidentiality of employee records are more likely to be included (Chart 3).[15]

Respondents from all regions cited three categories of problems addressed by their ethics statements which were not included in the questionnaire: (1) employee "outside activities" (e.g., consulting income, political activity and contributions); (2) fair conduct toward competitors; and (3) inappropriate gifts.

Changes in Individual Codes

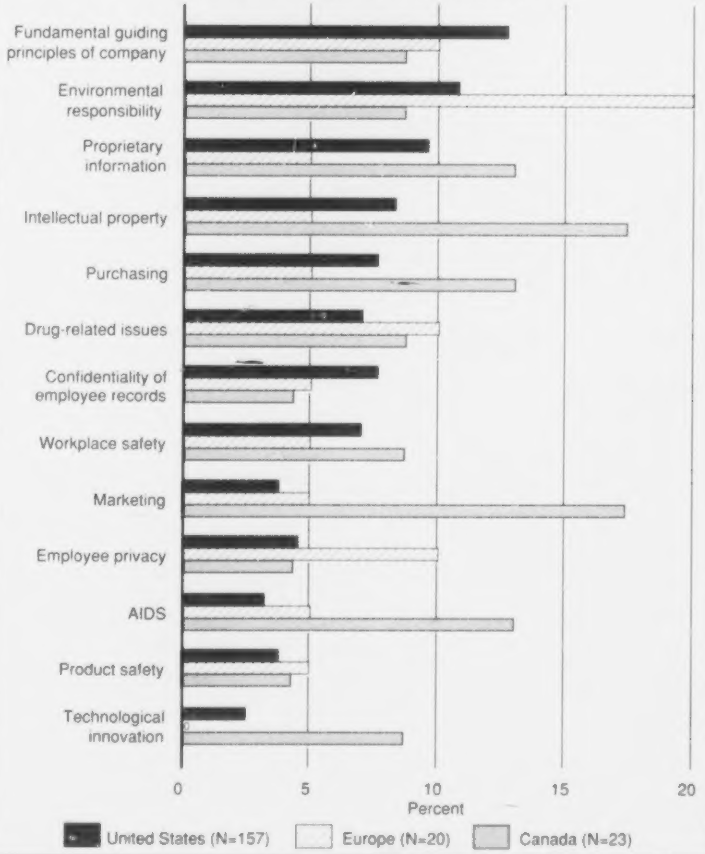
In the three years prior to the current survey, 24 companies addressed the organization's fundamental guiding principles through provisions added to their codes. Environmental responsibility was the only other subject added to more than 10 percent of the codes (23 companies).[16] (For examples of environmental accountability statements, see Exhibits 4 and 5, pp. 36-38.)

Safeguards for proprietary information (19 companies) and intellectual property (18 companies) were also frequent subjects of new code provisions (see Chart 4). The interest in environmental problems, and the security of proprietary information, is consistent with survey findings in the 1987 study in which participants rated these topics as "ethical issues that require additional attention." However, the 1987 issue most often cited requiring further attention — employee health screening for problems such as drug abuse (15 companies) and AIDS (9 companies) — was less frequently addressed by additions to company codes in the current study (see Chart 4).

Code revisions were much less common than additions. Outside the United States additions were practically unknown. Drug policies (11 companies) and security of proprietary information (10 companies) were the most frequent subjects of change.

A specific internal incident was the most frequently cited reason for code additions and revisions. These incidents were not necessarily cases of employee ethical misconduct. For example, one European company cited a total quality management initiative. Another European firm commented on the need to develop standards of professionalism for company managers. Other respondents noted the growing importance of issues such as environmentalism or plant safety for their organizations. A new CEO, or legislation such as the 1977 Foreign Corrupt Practices Act (amended, 1988), the 1989 Ethics Reform Act, and the 1985 Bank Bribery

Chart 4:
Subjects Added to Company Ethics Statements Within the Last Three Years
(200 code companies responding)



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[14] For a discussion of intellectual property safeguards, see Ronald E. Berenbeim, *Safeguarding Intellectual Property*.

[15] Interest in confidentiality of employee records may be due to the requirements of Canada's Privacy Act. See Berenbeim, *Employee Privacy*, Report No. 945, The Conference Board, 1990, pp. 1-2.

[16] For a discussion of current corporate environmental concerns, see Barbara H. Peters and James L. Peters, eds., *Corporate Stewardship of The Environment*, Report No. 981, The Conference Board, 1991.

Act were the next most likely reasons for code amendment or revisions (see Chart 5).

More detailed comments suggest many of the changes were due to insistent demands from the company's leadership. The CEO was mentioned most often in this regard, but other interested parties included the general auditor, the chief financial officer, the human resource staff, and the senior management group.

The increasing involvement in global markets, particularly among U.S. companies, has also given rise to company efforts to define core principles. As one participant put it: "We are becoming increasingly global. As we do a larger share of business outside the United States, there is a need for a code as a focal point."

Participants in Code Drafting

Respondents to the 1987 survey were asked about the involvement of five different potential participants in code drafting: (1) founder or member of founder's family; (2) board of directors; (3) top management; (4) legal department; and (5) consultants. The level of involvement of the founder or founding family members, top management, and consultants among 1991 survey participants is little changed from the 1987 figures. Respondents to the 1991 survey reported much higher participation levels in code drafting for the general counsel (78 percent) and the board of directors (41 percent) (see Chart 6). See adjacent box for a list of companies that have an ethics or social responsibility committee of the board of directors, and box on p. 16 for discussion of their role in ethics programs. General counsels are especially active in the United States (84 percent) and boards of directors are used extensively in Europe (60 percent).

The current questionnaire also solicited information about the inclusion in the code drafting process of high-ranking executives from functional departments (e.g., human resources), worker representatives, or randomly selected groups of employees. The United States, Europe and Canada have very different patterns of executive and employee involvement in code formulation (see Chart 7). These contrasting approaches reveal

Companies That Have a Board of Directors Ethics or Social Responsibility Committee

A.B.B. Lummus Crest Inc. (United States)
The A.R.A. Group, Inc. (United States)
Avery Dennison Corp. (United States)
R.R. Donnelley & Sons Co. (United States)
Farmland Industries, Inc. (United States)
General Mills, Inc. (United States)
KPMG (The Netherlands)
Levi Strauss Associates Inc. (United States)
Martin Marietta Corporation (United States)
Millipore Corporation (United States)
Montreal Trust Company (Canada)
Polaroid Corporation (United States)
Provigo Inc. (Canada)
Texaco Inc. (United States)
Union Bank of Finland Ltd. (Finland)
Warner-Lambert Company (United States)
Westinghouse Electric Corporation (United States)
Zurn Industries, Inc. (United States)

Chart 5:
Reasons for Additions/Revisions of Company Ethics Statements
(200 code companies responding)

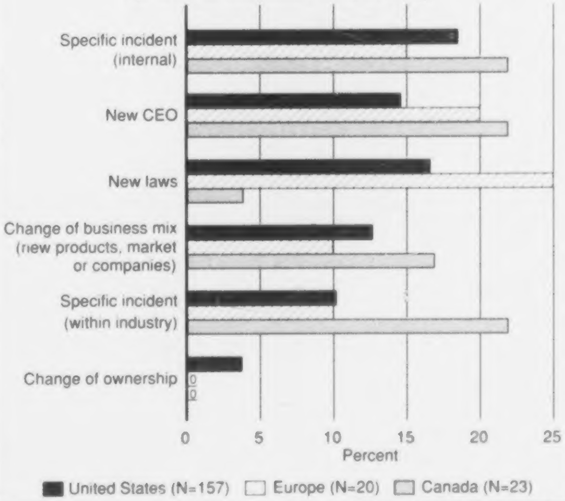
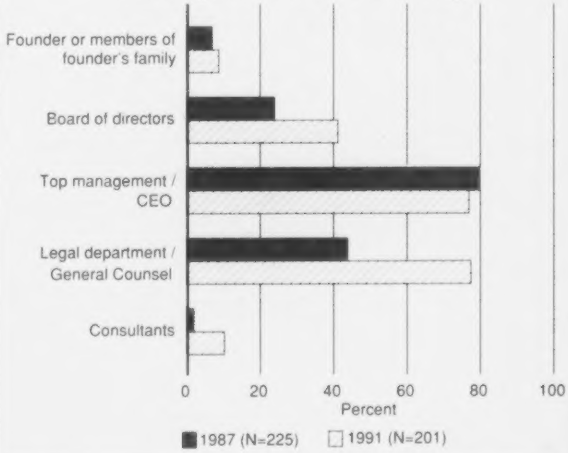


Chart 6:
Participants in Code Drafting



Board of Directors Ethics Committees

Nearly 10 percent of the boards of directors in the sample (24 companies), have an ethics committee. This practice is less common in Europe where only 2 out of the 40 surveyed companies have them. With the exception of one Canadian firm, all of these organizations also have ethics statements.

The composition of these committees varies by region. The two European bodies have only inside directors. In the United States and Canada, there is a slight preference for a mix of inside and outside directors (13 companies) over limiting appointment to outside directors (nine companies). No U.S. or Canadian board ethics committee consists solely of inside directors.

In the U.S., the chairman is almost always an outside director (two exceptions), whereas the Canadian respondents with ethics committees were evenly divided (i.e., two company board committees are chaired by an inside director and two are headed by an outside director).

The purpose of these committees varies widely from fairly narrowly defined charters to broader grants of jurisdiction. One of the more expansive descriptions was provided by a U.S. defense contractor that said its committee "consider[s] all proposed policy which impinges on ethics." The narrower view generally confines the committee's focus to conflict of interest questions.

A number of U.S. respondents gave specific examples of the policy subject matter that falls within the purview of a broadly defined committee charter: (1) social responsibility; (2) safety; (3) environmental, or (4) human resources. The most comprehensive range of concerns for a board ethics committee was cited by a Canadian company — fair employment, recruiting activity, individual rights, human resources, and environmental issues.

Many board ethics committee have extensive responsibilities to review sensitive company matters. Practices and transactions cited in this regard are audits, status of pending litigation, reports of policy violations, and the adequacy of financial information.

Finally, some board ethics committees exercise oversight for the organization's ethics training programs, and updates of the company's code. (For an example of a board of directors ethics committee charter, see below.)

Westinghouse Electric Corporation: Ethics Committee Charter

The Ethics Committee shall provide a general review and shall address all issues concerning or relating to ethical conduct by the Corporation and its employees in all phases of the Corporation's activities. To accomplish its purposes, the Committee shall:

a) Review activities of the Corporation and its employees relevant to the Westinghouse Code of Business Ethics and Conduct, and the continuing program established by management and administered by the Corporation's Ethics Office in order to promote the highest standards of business ethics for the Corporation.

b) Review matters relating to education, training and communications in connection with the Corporations's Code of Business Ethics and Conduct and related ethics programs.

c) Review other issues involving ethics as they relate to the Corporation's mission, relationship to its constituencies, policies and procedures, or any other matter the Committee deems appropriate.

d) Retain and consult with any advisors or consultants it deems necessary or appropriate, including the Corporation's General Counsel and its independent accountant, in all matters relating to business ethics.

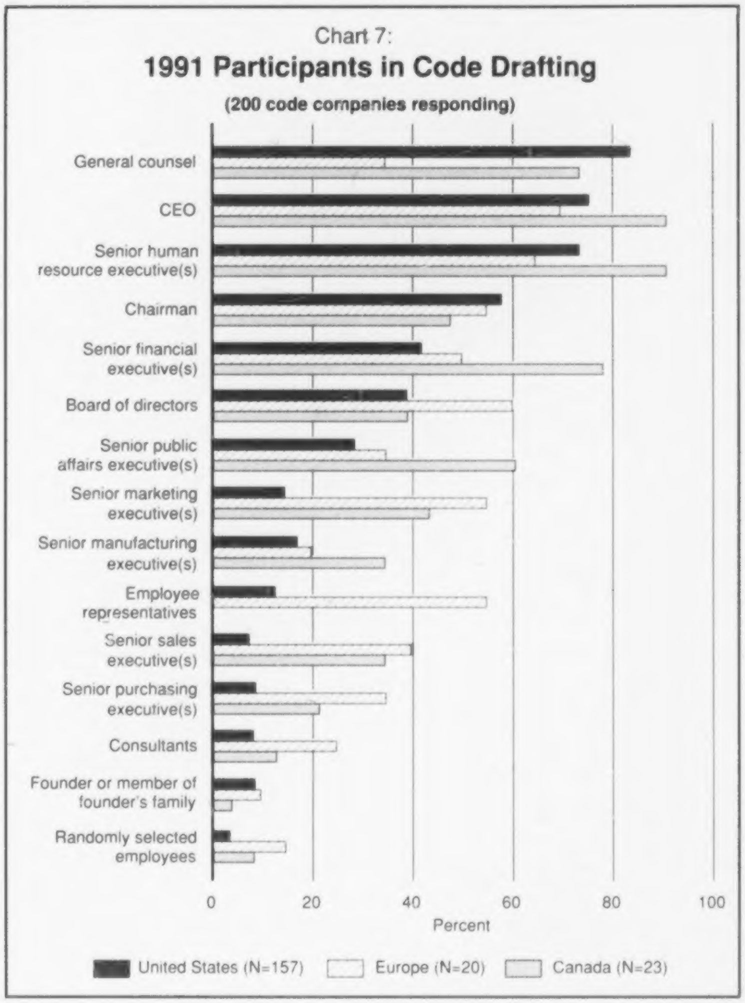
e) Present to the Westinghouse Board, as appropriate, such measures and recommend such actions as may be necessary or desirable to assist the Corporation in conducting its activities in accordance with the highest standards of business ethics, and provide to each director a copy of the minutes of each Ethics Committee meeting.

f) Annually review this Charter and, as appropriate, recommend amendments to the Westinghouse Board.

Chart 7:

1991 Participants in Code Drafting

(200 code companies responding)



potentially divergent views among U.S., European, and Canadian responding companies as to the primary nature and purpose of a corporate ethics code.

The United States: the code as a legal document. The near universal inclusion of the general counsel (84 percent) in U.S. ethics code deliberations suggests that many U.S. companies believe their codes require the same careful drafting used in legal documents. These statements may have underlying legislative or administrative compliance purposes (particularly among defense contractors) or enforcement mechanisms (e.g., provisions to protect proprietary information or intellectual property).

The heavy reliance on top human resource executives may be due to the tendency to address aspects of the employer-employee contract in adding to or revising provisions in corporate ethics statements (see Chart 3).

Europe: the code as a social compact between the company and its workers. In contrast to the U.S. pattern, only 35 percent of European companies consult their general counsel in code drafting (see Chart 7). They are more likely to discuss code issues with employee representatives (55 percent). This procedure is used by very few U.S. companies (13 percent). Although the prevalence of codes among survey participants is lower in Europe than in the United States or Canada, there may be an effort among those companies that do have them to use ethics statements to develop uniform standards that are in harmony with European Community (EC) directives on employee rights and corporate social responsibility (see box, p. 18).

European companies also reported higher levels of involvement in code formulation by senior marketing, sales and purchasing executives (see Chart 7). This finding may reflect a special European concern with these issues during the years 1987-91. Finally, a larger percentage (25 percent) of European companies used consultants in code drafting.

Canada: the code as a collaborative effort between the CEO and senior executives of major functional departments to set forth company's basic principles. In code formulation, Canadian companies were more likely to involve the CEO (91 percent) and senior executives from major departments such as human resources (91 percent), public affairs (61 percent), and finance (78 percent). Inclusion of the general counsel is also fairly common (74 percent), but the involvement of consultants is rare (13 percent). Employee representatives did not participate in code deliberations with any of the responding companies.

Code formulation in Canadian companies appears to be a collegial process that involves the heads of many major departments (see Exhibit 6, p. 39). Rather than serving as a compliance or enforcement mechanism, or as an element in the social contract, the drafting of Canadian codes may be part of a process that seeks to achieve consensus on the company's common principles and purposes.

Code Distribution Practices

There is a clear trend in favor of distributing the company's code to all employees. In 1987, nearly two-thirds of the responding code companies gave it to all their employees.[17] Among 1991 survey participants, 77

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[17] Berenbeim, *Corporate Ethics*, p. 17.

Dow Europe: Using a Corporate Vision Statement for Strategic Direction

Dow Chemical Company's Vision statement is intended to provide local units with a "clear operating philosophy and strong management principles." While the vision states the company's overall strategic direction, "individual units are encouraged to interpret and implement this strategy to achieve particular goals."

The most recent version of Vision was enacted in 1989; it represents the latest in an ongoing process of refinement and discussion of core principles that are about 25 years old (see "Dow Core Values"). Dow Europe has made extensive use of Vision. It has been distributed to more than 3,000 employees throughout Europe and translated into local languages for country-wide operations. Vision has been used by company planners to define Dow Europe's contribution to the company's financial goals and to secure for European operations a larger commitment to research in Europe.

In a series of discussions, senior executives of Dow Europe explained how individual operating departments had interpreted and implemented Vision within the company's European operations.

Vision's strategy cites people as one of its "five integral elements" (see "People"). Dow Europe is no less committed to this particular aspect of Vision than the parent company, but the organization's senior human resource executive thinks that "on purely human issues, European and U.S. employees do not have exactly the same concerns." For example, most European countries have extensive protections for job security. Even so, these safeguards have not always been helpful: "Restructuring in Europe has been quite brutal. The loss of jobs has been dramatic in steel, coal, automobiles, fibres, and chemicals."

The Dow Vision offers a timely response to these current restructuring anxieties. Since its original formulation over 25 years ago, Vision has emphasized the company's determination to "foster an environment in which people look forward to change and are committed to improvement through a life-long pursuit of continuous personal development." Dow seeks to expand its employees' horizons through training and development programs, and other opportunities that encourage initiative, entrepreneurialism, and decentralization of responsibility and authority.

Many European human resource planners do not yet share the major U.S. concern with work force diversity. With the possible exception of the influx of women in some regions and industries, these managers believe that the overall demographic mix of most work forces is not likely to change dramatically. With respect to human resource issues, Dow Europe is confident that the basic commitments outlined in its strategic principles can be applied anywhere and that the personnel practices of all Dow units "would be in harmony with the European social charter."

Similarly, Dow Europe seeks to establish manufacturing and safety policies that enable the company to operate in every country. In practice, achieving this objective means "ignoring the problems that Southern Europe has in catching up with the more environmentally conscious northern countries." Developing uniform standards based on the requirements of advanced jurisdictions means that certain locations are unsuitable. Commenting on this point, the General Counsel said, "We would not invest in a country where we can't ensure that our own standards are met."

Dow Core Values

If you can't do it better, why do it?

H.H. Dow, Founder

Long-term profit growth is essential to ensure the prosperity and well-being of Dow employees, stockholders, and customers. How we achieve this objective is as important as the objective itself. Fundamental to our success are the core values we believe in and practice.

Employees *are the source of Dow's success. We treat them with respect, promote teamwork, and encourage personal freedom and growth. Excellence in performance is sought and rewarded.*

Customers *will receive our strongest possible commitment to meet their needs with high quality products and superior service.*

Our Products *are based on continuing excellence and innovation in chemistry-related sciences and technology.*

Our Conduct *demonstrates a deep concern for ethics, citizenship, safety, health and the environment.*

People

Our employees are the source of Dow's success. We treat them with respect, promote teamwork, and encourage personal freedom and growth. Excellence in performance is sought and rewarded.

We will foster an environment in which people look forward to change and are committed to improvement through a life-long pursuit of continuous personal development.

We will emphasize respect for the individual through:

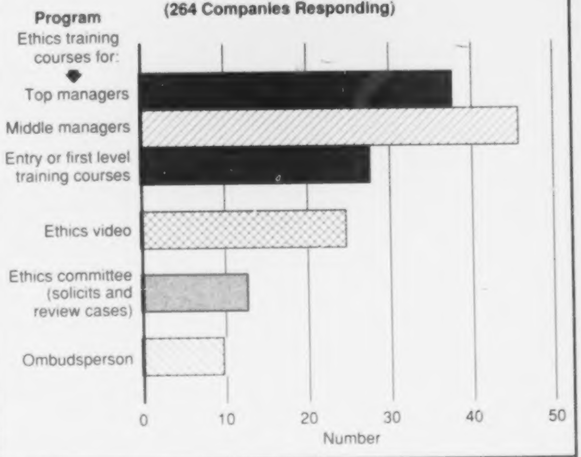
- Encouragement of entrepreneurialism.
- Training and development programs.
- Decentralization of responsibility and authority.
- Liberation and utilization of talent and experience.
- Recognition of individual initiative in the achievement of team success.

percent followed this practice. (The figure for Canada (83 percent) was slightly higher than the U.S. or European percentages.) Twenty-two percent of the code company respondents limit distribution to top and middle-managers (down from over one-third in 1987), and just a handful (three companies) give the code only to top managers.

Distribution to employees in overseas divisions is common, but not universal — 72 percent of the survey participants engage in this practice. Canadian companies are somewhat less likely to disseminate codes in this manner than are U.S. or European organizations.

European companies are more likely to modify these documents for use outside the home country (25 percent) than are U.S. (14 percent) or Canadian organizations (13 percent). In fact, nearly half (45 percent) of the European companies have branches, subsidiaries or divisions that have their own codes. This practice is much less common in U.S. and Canadian firms.

Chart 8:
Ethics Programs Sponsored Within the Last Three Years
(264 Companies Responding)



New Ethics Training Programs

One-fourth of the responding companies (66) have established new ethics training programs, ethics committees, or ombudsperson's offices during the last three years. For code companies, particularly in the United States, the percentage is one-third, because only four organizations that did not have ethics statements sponsored such initiatives.[18] New ethics programs were also much less common in Europe and Canada — only 12 companies (16 percent) inaugurated them prior to the survey.

Training courses utilize a variety of formats. Some are limited in scope to discussion of the company's ethics statement: others seek to promote ethical sensitivity through Socratic exercises that require participants to analyze case studies that present commonplace ethical dilemmas.

Survey respondents say that the major area for new program initiatives has been study groups for middle managers. One-fourth of the U.S. code companies and one-fifth of the European code organizations started new ethics training courses for this category during the past three years. (The practice was less common in Canada — 13 percent.) (For an example of company-developed ethics study materials, see Exhibit 7, p. 40.) Many new initiatives for top managers (38 companies) and entry-level employees (28 companies) were also begun, and ethics videos were popular (25 companies). Ethics committees and ombudsperson's offices were less frequent additions to company ethics programs (see Chart 8). To track these corporate initiatives, Westinghouse issues an annual report on its ethics program that contains charts showing the program's achievements during 1989 and its plans for 1990 (see Exhibit 8, p. 41).

Citicorp's board game "The Work Ethic" is a novel approach to in-house ethics education. The game offers over 100 questions that differ depending on job, industry and geography. Several answers are permissible, but one is awarded most points for being "best." After teams vote on the answer, the facilitator plays devil's advocate and challenges the players on all points. The "senior management appeals board," a team of three-to-five senior managers, can overrule or allow any decision reached by a team. Their participation improves employee awareness that top managers are knowledgeable about ethics, and approachable if advice is needed.[19]

Most company ethics training projects utilize materials developed in-house and rely on company executives as facilitators. The exceptions are top-manager discussion groups and ethics videos. Still, over two-thirds of the new programs in these categories were generated by the company and use the organization's own employees as discussion leaders.

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[18] The 1987 survey found that 19 percent of the non-code companies had some kind of ethics training or discussion program (compared with 44 percent of code companies). Evidently, new efforts or serious modifications of old programs are rare among companies that do not have the ongoing discussion that an existing code can provoke. See Berenbeim, *Corporate Ethics*, pp. 17-18.

[19] For more about "The Work Ethic" board game, see Terry Brothers, ed., *Corporate Ethics: Developing New Standards of Accountability*, R-980, The Conference Board, 1991, pp. 27-29.

Conclusion

Once regarded as a reactive phenomenon to deflect cyclical outbursts of public distrust of business institutions, corporate ethics codes and programs now enjoy a broad base of support within individual companies.

The current corporate commitment to ethics codes and programs appears to be driven in large measure by internal needs and, as de Tocqueville defined ethics, "self-interest, rightly understood."

Four issues of great importance to senior managers are: the degree of personal responsibility and accountability that total quality management (TQM) demands; the need to define core company principles when doing business in a global environment; managing a more diverse work force; and the poor level of preparation available in public school education. Each of these concerns suggests companies need to pursue an active role in helping their employees to achieve a high level of ethical literacy.

Evidence of this awareness can be seen in the participation of heads of major departments (e.g., human resources, finance) in the formulation of ethics codes and statements. The increasing involvement of general counsels suggests that codes are viewed as legal documents which establish the accountability of the company and its employees to one another and to the general public.

With respect to actual content, the 1991 survey findings show that elements of the employment contract (e.g., employee honesty, workplace safety) are the specific subjects most often discussed in codes. This focus explains why (along with the CEO and the general counsel) the company's senior human resource managers are usually involved in code drafting.

Companies are also recognizing that in addition to stating their ethical principles, they need to sponsor programs that help employees develop a sensitivity to and awareness of ethical issues. One-fourth of the participating companies started new discussion programs (among code companies the percentage was higher — nearly one-third). Training sessions for middle managers were the most popular initiative in this regard. Most of these projects utilized materials developed in-house, and relied on company executives as facilitators.

None of this documentation of company effort and commitment suggests that business institutions have become more or less ethical. What these data do affirm is that senior managers now recognize that dealing with ethics issues is part of nearly every employee's job. When the company has a broad-based, institutionalized process for formulating its core principles — supplemented with ethics discussion groups — it is helping employees to do their jobs better.

Dealing With Practical Situations: Three Case Studies

To illustrate how senior managers of responding companies would analyze specific situations that might involve ethical issues, participants were asked for their views on three hypothetical cases. They were also asked whether each situation involved ethical as well as business considerations.

Participants were asked for their own views rather than for statements of their company's policy. They also ranked (1, 2 or 3) the three reasons (from a list of six) that most influenced their thinking. Finally, they were asked to choose from various policy options for dealing with the problems raised by the hypothetical case. Approximately one-fourth of the participants commented on each problem and many of these observations follow. Except in those situations where it is indicated, there were few differences between U.S., European and Canadian respondents.

Though the facts presented correspond to no individual company or occurrence, each case depicts real issues encountered by managers and those who research business practices. The cases presented and the questions asked are reprinted in their entirety. Each text is followed by a discussion that includes tabulation of the responses and representative comments by participants.

Case One: Employee Assistance Programs and a Promotion Decision

Archer Corporation has an Employee Assistance Program (EAP) that offers counseling for alcohol and substance abuse, mental and psychiatric problems.

In 1985, Bob Spicer, a 15-year sales staff veteran and frequent winner of annual performance awards, told his boss, Joe Sampson, "I have been drinking a lot because I am depressed about my personal problems." Sampson referred him to the EAP. Before, and since that time, Spicer's job ratings have been consistently superior. The company does not have access to his medical records and does not know whether he ever obtained or is currently receiving counseling for depression. Joe Sampson, the manager whom Spicer consulted, is now CEO of Archer.

In November, 1990, Spicer applied for the high stress position of vice president, sales, a job for which his performance merits serious consideration. In reviewing his qualifications:

Table 1: Case One Responses*

	Number	*Percent of Responses*
1. *Sampson should (check one):*		
Ask Spicer if he is still "depressed"; his response is relevant to whether he qualified for the job.	92	37%
Not discuss the issue with Spicer; but his complaint of being "depressed" should be a factor in considering him for the job.	3	1
Ignore Spicer's 1985 "depression" complaint because his performance has been excellent and his personal problems are irrelevant in making the promotional decision.	82	33
Exclude the "depression" incident from consideration in the promotional decision because it occurred more than five years ago.	74	29
2. *In making his decision Sampson (check one):*		
Is confronting ethical as well as business considerations.	173	72
Can resolve the issue by limiting discussion to standard personnel policies.	67	28
3. *Archer's policy with respect to known employee health complaints should be to (check one):*		
Exclude use in making any assignments or promotions.	13	5
Consider them when performance related.	181	74
Consider if performance related, but exclude if they occurred more than three years ago.	50	20

* *Because of rounding percentages do not always add up to 100.*

Case One: Discussion

The respondents were very closely divided between three different approaches to deciding the Spicer promotion. A plurality (37 percent) favored asking Spicer if he was still "depressed" because it is relevant to whether he is qualified for the job. Despite the relevance of the depression incident, nearly two-thirds of the sample (62 percent) would ignore it for one of two reasons. Thirty-three percent would not allow the 1985 depression complaint to be a consideration because of Spicer's excellent performance and the irrelevance of personal problems in making promotion decisions. Twenty-nine percent would ignore the "depression" incident because it took place more than five years ago. Only three respondents (1 percent) would allow the "depression" complaint to be a factor without discussing it with Spicer (see Table 1).

Nearly three-fourths (72 percent) of the respondents said that the case raised ethical issues and could not be resolved by limiting the discussion to standard personnel policies. European companies were somewhat more likely to hold this view (83 percent), and Canadian respondents (60 percent) were less likely to feel that Archer confronted ethical as well as business issues in considering Spicer for a promotion.

The three principles most often cited as controlling in deliberations over Spicer's promotion were: (1) Spicer's performance record; (2) general principles of fairness; and (3) relevance of "depression" to job requirements (see Table 2).

Comments show that many participants saw a close relationship between these three factors. Some saw Spicer's performance as a clear indication he was no longer "depressed," and information about the 1985 episode was no longer relevant. Others believed the "fairness" rationale imposed an obligation on the company to discuss with Spicer whether he now felt he was able to cope with a high-stress position. While no one argued that depression and heavy drinking were irrelevant in making the promotional decision, some respondents said this particular situation was not pertinent because of the length of time elapsed since it occurred, and Spicer's exemplary record during that period.

Only 13 respondents believe that Archer's policy with respect to known health complaints (5 percent) should be to exclude them in making any assignments or promotions. Fifty participants (20 percent) would not allow such incidents to be a factor if they occurred more than three years ago. Nearly three-fourths of the sample (74 percent) would consider any health problems that were performance related.

Table 2: Factors That Most Influenced Responses

Consideration	*Total Points**
Employee's performance record	530
General principles of fairness	391
Relevance of "depression" to job requirements	231
Employee rights	148
Need to maintain confidentiality of EAP records	111
Effect of decision on morale of other employees	45

**Participants were asked to rank in order (1, 2, 3) the top three considerations that most influenced their thinking in deciding how to handle the problem. Three points were awarded for a (1), two for a (2), and one for a (3). The individual factors were then ranked in importance according to the total number of points.*

The Case for Discussing the Depression Incident with Spicer

Participant comments supporting discussion of the incident with Spicer sought to balance company and employee interests. The CEO of a Canadian financial organization stated this view succinctly: "The question of fairness applies to both the company and the employee. The company wants performance, but it does not want to force the employee into a position that will cause recurrence of the former problem."

Many participants who argued in favor of discussion with Spicer did so out of concern for his welfare. Typical of this group was the executive director of a Mexican manufacturing firm, who argued that "If I offer Spicer a job that will 'break' him, I am responsible. Spicer is a whole person and his integrity takes precedence over a promotion." The personnel director of a U.S. manufacturer echoed this view: "It would be unfair for a candidate not to seriously consider the potential harmful effects of increased stress."

The human resource vice president of a U.S. manufacturer said that it was "reasonable" to discuss the subject (without looking at EAP records) because Spicer "brought it up." A Canadian industrialist cautioned that any conversation was limited by Spicer's willingness to cooperate: "The issue cannot be pursued or considered unless Bob Spicer is willing."

Some commentators thought the current relationship between Sampson and Spicer was the key to whether discussion of Spicer's "depression" should be part of the promotion decision. The vice president, employee relations of a U.S. construction company noted that the facts did not state whether the supervisory relationship between Sampson and Spicer had continued up to the time of Spicer's candidacy for the position of vice-president, sales. If it had, and Sampson had observed no problems, the "depression" complaint could be disregarded. If Spicer no longer worked for Sampson, then an inquiry about Spicer's current condition would be necessary.

Other participants assumed an ongoing relationship of trust that would make discussion of Spicer's condition helpful and non-stressful for all concerned. The view of the vice president, audit operations of a U.S. financial service organization summarized this view, which was shared by other respondents: "Since Spicer was able to talk to Sampson, the two men obviously have an ideal open relationship. My choice might be more difficult if there was a lower level of trust in the prior relationship."

The Case Against Discussion With Spicer

Those who did not favor discussion of the "depression" incident held this view because of Spicer's exemplary performance record and the length of time that had elapsed since the incident occurred. Nonetheless, they cautioned that although the ethically appropriate approach would be to avoid consideration or discussion of Spicer's 1985 "depression" episode, the exclusion of known facts from the decision-making process would be very difficult. The manager, organizational development, of a U.S. bank summed up the quandary experienced by this group: "A responsible CEO would have a difficult time not considering health problems that affect performance; but ethically, performance should be the only issue."

The vice president, human resources, of a U.S. manufacturer also noted that it was hard for the ultimate decision-maker to ignore a problem of which he was aware, but this commentator suggested another ground for exclusion: "The bright side of this is the fact that Spicer brought the problem forward and corrected it."

The most common rationale for exclusion was that debilitating alcoholism or depression could not have gone unnoticed. The general counsel and secretary of a U.S. manufacturer said, "serious alcoholism or depression would have affected performance after 1985." A British communications company quality representative agreed: "The passage of time and performance are the key issues."

The Confidentiality of EAP Records: a Collateral Concern

Regardless of whether they thought that a discussion of Spicer's "depression" problems should or should not take place, many participants commented on the importance of limiting the investigation to conversations with Spicer. They felt that, if the company had to choose between maintaining the confidentiality of the EAP records and having additional information about Spicer, EAP confidentiality was the paramount interest. Typical of this view was the comment of the vice president, human resources, planning, and development, of a Canadian bank: "One would expect Sampson to know Spicer well enough to be able to assess his current suitability for the job. In any event, confidentiality of EAP records must be absolute, and seen by all employees to be so." A human resource planner for a U.S. utility agreed: "If EAP files are 'open' and used, their credibility and utilization would decrease."

Case Two: Accommodating a Local Distributor

Dagonet, a diversified manufacturer, is undertaking a major effort to introduce its products in Latin American markets. The company has been asked by several potential distributors to overbill and remit the differences to their company's accounts in Switzerland and the Cayman Islands. The practice is customary in these countries because local taxes are confiscatory and the local exchange rates make it very difficult for local distributors to achieve profitable results. Dagonet has received similar requests in the past from U.S. and European firms and has always refused. Under the circumstances:

Table 3: Case Two Responses

	Number	*Percent of Responses*
1. Dagonet should (check one):		
Deny the request because what is unethical in one country cannot be ethical in another.	224	90%
Accede to the request because it does not violate the local distributors' standard business practices.	25	10
2. In making its decision, Dagonet (check one):		
Is confronting ethical as well as business considerations.	233	94
Can resolve the issue by limiting discussion to accepted local business practices.	16	6
3. With respect to ethical considerations in distributor relations, Dagonet should (check one):		
Have one policy worldwide.	196	82
Allow local subsidiaries to formulate policy based on regional customs and practices.	44	18

Case Two: Discussion

There was widespread agreement (90 percent) that the distributors' request should be denied and that Dagonet confronted ethical as well as business issues in making this decision (94 percent). Participants were somewhat less likely (82 percent) to agree that Dagonet should have one policy worldwide (see Table 3).

There was less consensus on reasons for not cooperating with the distributor. U.S., European, and Canadian participants ranked "the company's well-established policy" first among the reasons for the decision, but this consideration did not receive the wide support enjoyed by the leading rationale in the other two cases. Rather than focusing on what the company should actually do in this situation (most said that the company should not overbill), the major debate for the participants was over how flexible the firm should be in the application of its policies in diverse countries and cultures.

The second most cited factor — "integrity and morale of company employees" — was somewhat less popular with Canadian respondents for whom it was much more narrowly preferred over "profitability and sound business practices" for the number two position.

Finally, Canadian and European participants did not rank "U.S. view of ethical business practices" among the top three rationales. Both groups chose "profitability and sound business practices" as the third most often cited reason for their decision. This divergence of opinion from U.S. respondents may be due to a problem with the text of the question. Dagonet was a U.S. company and the intent was to determine whether corporate headquarters should take the position that its own country's ethical standards (in this case, the U.S.) should be controlling in other parts of the world. Evidently that point was not clear. One U.K. commentator noted the confusion: "Does this choice mean that the U.S. view should be a major factor in all companies?" (see Table 4).

Table 4: Factors That Most Influenced Responses

Consideration	*Total Points**
The company's well established policy	438
Integrity and morale of company employees	333
U.S. view of ethical business practices	250
Fairness to all distributors with which the company does business	208
Profitability and sound business practices	159
Local custom as to ethical business practices	89

**Participants were asked to rank in order (1, 2, 3) the top three considerations that most influenced their thinking in deciding how to handle the problem. Three points were awarded for a (1), two for a (2), and one for a (3). The individual factors were then ranked in importance according to the total number of points.*

The Case for Defining Core Beliefs

Many participants said that Dagonet should be respectful of local customs and practices but that it was important for decision makers to be aware of the company's core principles and to be certain that no action taken contradicts these fundamental beliefs. The general counsel of a U.S. food company stressed the importance of limiting acquiescence to local practices to situations where the company did not violate this rule: "Local customs and practices should be considered, but not if the action would be in conflict with basic company beliefs. Dagonet's leadership will have to live with this decision." A senior European human resource manager went further. Within the limitations of its well-defined policy, the company should make every effort to agree to terms proposed by potential customers: "Ethical standards do vary from one country to another and companies should accommodate those variations provided they do not violate internal standards."

How should a company choose, if it must, between adherence to its core principles and flexibility and tolerance in dealing with local custom and practices? A U.S. manufacturer's government-business affairs counsel said that the choice must always favor the organization's internal moral compass: "A company should be consistent, its manager should not rely on 'situation ethics'." In fact, as the general counsel of a U.S. bank noted, "without trying to pass judgment on others, ethics decisions must be based on the company's standards."

Limitations on the Worldwide Application of Company Standards

Participants from all three sample groups warned that Dagonet could not expect acceptance of its principles everywhere that it did business. A human resource planner with a U.S. utility cautioned that "a 'one size fits all' policy would not be very practical and seems very unrealistic if the firm expects to participate in this market." This view was echoed by responses from both Europe and Canada. The director, professional practice, of a European-based business service organization said that "it is arrogant to suggest home ethics should override (are superior to) local ethics in all cases." The CEO of a Canadian utility concurred: "I'm not sure we can force our view of right and wrong on the whole world."

The vice president of a U.S. market research firm said that discussion of this kind of problem should distinguish between whether the local distributors were negotiating with the parent company or its local subsidiary. If it is the subsidiary that is involved, "multinationals must play by local rules provided local rules do not migrate home." The quality representative of a U.K. telecommunications company suggested a two-step analysis for defining acceptable conduct for subsidiaries faced with this problem: "(1) is the practice universal in this particular country; and (2) can the practice in question be contained within that country?"

Finally, the vice president, human resources of a U.S. bank was not alone in observing how easy it is to elect a highly principled alternative in a case study: "I have no overseas experience. I might be less high-minded if I had."

Case *Three:* Should "Questionable" Disbursements Be Investigated?

Lily Bart's mentor, Lawrence Selden, was promoted and Bart assumed his post as vice president of the general services division of Newland, Inc. Bart continues to report to Selden. In familiarizing herself with her new responsibilities, Bart discovers questionable disbursements for travel and entertainment expenses. The general counsel tells Bart that there has been no illegal conduct and that both Selden and his predecessor routinely approved such reimbursements despite their apparent violation of the company's ethics code. Under these circumstances:

Table 5: Case Three Responses*

	Number	*Percent of Responses*
1. Bart should (check one):		
Launch a formal investigation of all practices to determine real or potential abuses.	61	25%
Issue more detailed policies and enforce them with respect to future conduct.	183	74
Do nothing. The practices are legal and customary.	4	2
2. In making this decision, Bart (check one):		
Is confronting ethical as well as legal and business considerations.	199	80
Can resolve the issue by limiting discussion to legal and business considerations.	31	12
Is encountering a typical management problem in trying to establish her authority over a new department.	20	8
3. The general counsel should (check one):		
Only object to employee conduct that exposes the company to legal liability.	22	9
Object to employee conduct that violates the company's policies and ethics code.	224	91

** Because of rounding percentages do not always add up to 100.*

Case *Three:* Discussion

Although the general counsel affirmed that the "questionable" disbursements were "legal," and both Selden and his predecessor had routinely approved such reimbursements, only four respondents (all from U.S. companies) thought that Bart should do nothing. Nearly three-fourths (74 percent) of the sample recommended that Bart "issue more detailed policies and enforce them with respect to future conduct." European and Canadian participants were somewhat more likely to favor a formal investigation.

Eighty percent of the respondents thought that this situation confronted Bart with ethical as well as business and legal considerations. The remainder was divided between those who did not think the problem had ethical dimensions (12 percent) and those who viewed the matter as a "typical management problem in trying to establish authority over a new department (8 percent)."

Participants were nearly unanimous (91 percent) in the view that the general counsel had an obligation to object to conduct that may violate company policy or ethics code. Determining the appropriate role for the general counsel provoked considerable comment as to how involved the company's chief legal officer should have been in past practices and in achieving compliance with any future regulations. The endorsement of general counsel involvement in ethics compliance activity was equally widespread in Europe, where questionnaire responses indicate they are not as likely as their U.S. or Canadian counterparts to be involved in code drafting (see Table 5).

In giving reasons for their choices, participants showed a marked preference for high principle tempered by pragmatism. The maintenance of "managerial integrity" received the highest approval level of any decision-making consideration offered in the three case studies. Those choices that focused on Bart's survival (loyalty to Selden, avoidance of negative impact on her own career) got the lowest number of points of any proposed rationale within the three case studies. Although self-interest was given a low priority in making the decision, pragmatism (actual chance of improving employee behavior) was acknowledged to be important and finished third (see Table 6).

The Case for More Detailed Policies

Comments that favored more detailed policies for application of ethical principles expressed general concerns with fairness and due process. New regulations were also seen as the most practical and effective way of achieving improvement in compliance with Newland Inc.'s ethics code.

The general counsel of a U.S. pharmaceutical company addressed the due process and fairness issues:

Table 6: Factors that Most Influenced Responses

Consideration	*Total Points**
Maintaining a high level of managerial integrity	653
Fairness and equity for company employees	371
Pragmatism (actual chance of improving employee behavior)	187
Avoiding conflicts of interest	133
Loyalty to a manager who has done nothing wrong and has advanced Bart's career	30
Avoidance of negative impact on Bart's career	22

**Participants were asked to rank in order (1, 2, 3) the top three considerations that most influenced their thinking in deciding how to handle the problem. Three points were awarded for a (1), two for a (2), and one for a (3). The individual factors were then ranked in importance according to the total number of points.*

"Since the expenses are 'questionable' that suggests that they are subject to question and not obvious, outright wrongs. There is an element of judgment involved. In such an instance, I would correct the problem going forward, as well as letting Selden know that he should keep a closer watch in this area."

Others favored new and more detailed regulations. Past infractions are hard to prove, and efforts to do so could be harmful to employee morale. The senior economist of a U.S. bank spoke for this group: "The travel and expense abuses are 'apparent' — but not facts. Proving that consistent abuse occurred appears difficult and could be disruptive. If a discreet, company-wide audit of such abuses is not feasible, then the company should rewrite the policy and include stricter enforcement provisions."

The manager of corporate concerns of a U.S. utility favored an investigation as well as new guidelines, and suggested it would be difficult to formulate changes in policy without a low-key inquiry: "Bart should initially contact Selden; they should meet and discuss what she has found and her view of the situation. Historical errors should be corrected to the extent that they can be reasonably identified. The intent should be to establish a new practice, not to search for the guilty."

The director of a U.S. manufacturer provided an agenda for the Bart-Selden meeting: "Bart and Selden should discuss why Selden thinks that such expenses are legitimate and they should try to resolve the problem at this level. It would be preferable for Selden to be the one to investigate and to issue new and more restrictive policies. If Selden is obviously wrong and unyielding, then Bart must decide whether to go over Selden's head and risk her career."

The vice president of a market research firm proposed a formula to help Bart determine whether she should "go over Selden's head": "Are Selden's exceptions a pattern of behavior or occasional, pragmatic exceptions? If there is evidence of a pattern of contempt for policy then Bart and the general counsel must report the problem to senior management."

Despite the widespread sentiment favoring new regulations and stricter future compliance efforts, some comments suggested skepticism that this action would solve the problem. The executive vice president and general auditor of a U.S. bank addressed these concerns: "While I think that issuing more detailed policies and enforcing them with respect to future conduct is the pragmatic choice, I am not entirely comfortable with it. It does, however, balance pragmatism against a stiff-necked response to the situation."

The Case for a Formal Investigation

A larger percentage of non-U.S. respondents favored some sort of investigation and most of the comments supporting this approach came from European or Canadian participants. The vice president, human resources, planning and development of a Canadian bank recommended an inquiry as to the fair way to handle the problem: "Until results of an investigation are available, the disbursements are only 'questionable' and any violation of the company's ethics code is only 'apparent'. An investigation is needed to either solidly establish wrong-doing or to clear Selden's name."

Other commentators suggested the investigation need not be formal. The head of corporate affairs of a European consumer products company said that "'formal investigation' could mean many things. The aim is to find out what was happening — and by whom — without the investigation itself becoming a cause célèbre. Action against individuals would depend on the outcome of this inquiry. Since the vice president approved these disbursements, sanctions would probably be limited to future behavior."

The director, external affairs of a European manufacturer agreed: The option to 'launch a formal investigation' sounds terribly threatening and vindictive. Bart should move ahead on a low-key basis by referring the situation to those in the organization who are responsible for dealing with such irregularities."

Bart's Difficult Position

Many comments focused on Bart's sensitive situation and noted that she could not address the problem without taking her own future into account. The vice president, human resources of a U.S. bank warned that "unfortunately the junior player bears all the risk. A big flap will only result in Bart being the loser. If I were

Bart, I'd look for a new mentor and probably a new job. Inevitably Selden will find out about the questions." The vice president, personnel of a U.S. manufacturer agreed: "New policies will probably not end the matter. I assume that Bart has 'clean hands'. She should be prepared to defend her actions and accept an interruption in her career."

To avoid a damaging break with Selden and any possible misunderstanding about the questionable reimbursements, the general counsel of a U.S. manufacturer suggested that she let Selden know "what she's doing and why. She might find out that there is an important business reason for the disbursements." The general counsel of a U.S. technology company recommended that instead of Selden or the general counsel, Bart should seek the advice of a third party: "This is a tough one for Bart. She should not have to fall on her sword the first day out. Her best course of action, although not really suggested here, should be to seek out another 'ear' other than the General Counsel, to discuss the situation and the best course of action."

The Role of the General Counsel

Many participants addressed the general counsel's role and conduct in this case. Although 91 percent of the respondents said that the general counsel should "object to employee conduct that violates the company's policies and ethics codes" a number of participants noted that the primary job of the general counsel is to give legal advice. Typical of this approach was the view expressed by the ethics officer of a U.S. manufacturer: "The general counsel should be charged with providing legal advice to senior management, who in turn has the responsibility to weigh all factors — ethical, business, and legal to arrive at appropriate decisions. I adamantly believe that ethics committees should be formed to avoid the general counsel having to weigh business ethics issues in addition to questions of legal integrity." The vice president and tax counsel of a U.S. pharmaceutical company agreed: "It is up to management to enforce policies and ethics — not the general counsel."

The vice president, human resources of a U.S. manufacturer disagreed and came closer to expressing the prevailing view: "The general counsel certainly must be concerned with legal liability, but I believe that the responsibilities of this position extend to company policies and ethics in general."

Two commentators who serve as general counsels for U.S. manufacturers went a good deal further than saying that the general counsel had responsibility for violations of company policy and compliance with its ethics code. They believe the counsel bore considerable responsibility for the infractions that Bart discovered. The first of these participants asked, "What kind of a spineless toady did the company hire as general counsel?" The second rendered an even more severe assessment: "The general counsel is ill informed; these payments are probably illegal if serious enough to be questionable. A general counsel who aids clear violations of the company's code of ethics should be removed immediately."

Exhibits

1. Compliance Code: The Provident Mutual Organization
2. Credo: United Technologies Corporation
3. Mission Statement: Vulcan Materials Company
4. Environmental Policy: Waste Management, Inc.
5. Environmental and Safety Operating Principles: Neste OY
6. Guiding Principles: The Great-West Life Assurance Company
7. Ethics Training Materials: Armstrong World Industries, Inc.
8. Setting and Meeting Ethics Program Objectives: Westinghouse Electric Corporation

Compliance Code: The Provident Mutual Organization

The Provident Mutual Organization

CODE OF CONDUCT

General Policy

The Provident Mutual organization is committed to achieving high standards of business and personal ethics for itself and its personnel. Through performance in accordance with these standards, the Organization and all its employees will merit and enjoy the respect of the public, the business community, policyholders, customers, and regulatory authorities.

It is the personal responsibility of all employees to acquaint themselves with the legal and policy standards and restrictions applicable to their assigned duties and responsibilities, and to conduct themselves accordingly. Over and above the strictly legal aspects involved, all company personnel are expected to observe high standards of business and personal ethics in the discharge of their assigned responsibilities.

Employee Conduct

Each member of the Organization must avoid any action, relationship or situation which could jeopardize or impair the confidence or respect in which the Organization is held by its customers and the general public, or which appears to be contrary to the interests of Provident Mutual or its policyholders.

Employees shall comply fully with all applicable statutes and regulations. Willful and knowing disregard of the law may result in severe penalties to the Organization. In its many business activities, Provident Mutual and its affiliated companies engage in vigorous, fair and ethical competition. Discussions and agreements with competitors concerning pricing or other competitive policies and practices are strictly prohibited.

Conflict of Interest

Provident Mutual annually circulates a policy statement of Conflicts of Interest. The basic policy states that every employee must avoid any interest that conflicts with the interests of Provident Mutual. The document provides detailed examples and explanations of situations and types of transactions which can give rise to conflicts of interest. In order to implement the conflict of interest policy of Provident Mutual, all officers and other affected persons are required to submit annually a completed disclosure statement to the Chairman and Chief Executive Officer of Provident Mutual. Each affiliated company has a similar requirement.

Gifts to or by Employees

Employees may not give or receive anything of more than token value to or from any individual or organization with whom Provident Mutual or its affiliates does business, or who is seeking to do business with Provident Mutual or its affiliates. "Token" is defined as having a value of $50 or less.

Certain business courtesies, such as payment for a lunch or dinner in connection with a business meeting, normally would not be a gift within the context of this policy. However, such activity shall be limited in frequency. Employees shall endeavor to avoid any situation where a gift or activity might appear to influence business judgment or relationships. Any question as to whether a gift might appear to be improper or questionable shall be addressed in writing, with a statement of all relevant facts, to the office of the General Counsel.

Political Contributions

No funds or assets of the Company shall be used for federal, state or local political campaign contributions. These prohibitions cover not only direct contributions but also indirect assistance or support of candidates or political parties through purchase of tickets to special dinners or other fund raising events or the furnishing of any other goods, services or equipment to political parties or committees.

No funds or assets of the Company shall be used directly or indirectly for political contributions outside the United States, even where permitted by applicable law, without the prior written approval of the Chief Executive Officer or General Counsel.

The above prohibitions apply only to the direct or indirect use of corporate funds or assets for political purposes and are, of course, not intended to discourage employees from making personal contributions to the candidates, parties or

(continued on next page)

Compliance Code: The Provident Mutual Organization *(continued)*

committees of their choice, through the Company's Political Action Committee. Under no circumstances shall employees be reimbursed in any way for personal contributions.

Confidential Information and Insider Trading

Employees frequently have access to confidential information concerning the Organization's business and the businesses of present and prospective customers, policyholders and other employees. Safeguarding confidential information is essential to the conduct of our business. Caution and discretion must be exercised in the use of such information, which should be shared only with those who have a clear and legitimate need and right to know.

No employee shall disclose confidential information of any type, to anyone, except persons within the employee's company who need to know. Information regarding a customer may not be released to third parties, government, or other organizations, without the consent of the customer unless required by law.

Any requests for information arising through a legal process (e.g., subpoena or court order) must first be referred to the office of the General Counsel before the release of information and before the client is contacted.

Selling or acquiring stocks, securities or other investments, on the basis of non public information is prohibited. Securities include stocks, bonds, notes, debentures, or any other interests, instruments, documents or rights which represent securities. Questions concerning the definition of non public information or a security shall be referred to the office of the General Counsel before any transactions are undertaken.

Service and Consumer Concerns

The foundation of the Organization is to provide high quality service to our existing and prospective customers. Each company endeavors to give prompt, courteous and accurate response to inquiries and complaints received from customers. When appropriate adjustments are warranted, employees will make them promptly and courteously. Equally important, we seek to add or improve policies, procedures and products that contribute to customer satisfaction.

Integrity of Records and Compliance with Accounting Procedures

Accuracy and reliability in the preparation of all business records is mandated by law. It is of critical importance to the corporate decision-making process and to the proper discharge of Provident Mutual's financial, legal and reporting obligations. All business records, expense accounts, vouchers, bills, payroll and service records and other reports are to be prepared with care and honesty. False or misleading entries are not permitted in the books and records of Provident Mutual or any affiliated company. All corporate funds and assets are to be recorded in accordance with applicable corporate procedures. Compliance with accounting procedures and internal control procedures is required at all times. It is the responsibility of all employees to insure that both the letter and the spirit of corporate accounting and internal control procedures are strictly adhered to at all times. They should advise the responsible person in their department of any shortcomings they observe in such procedures.

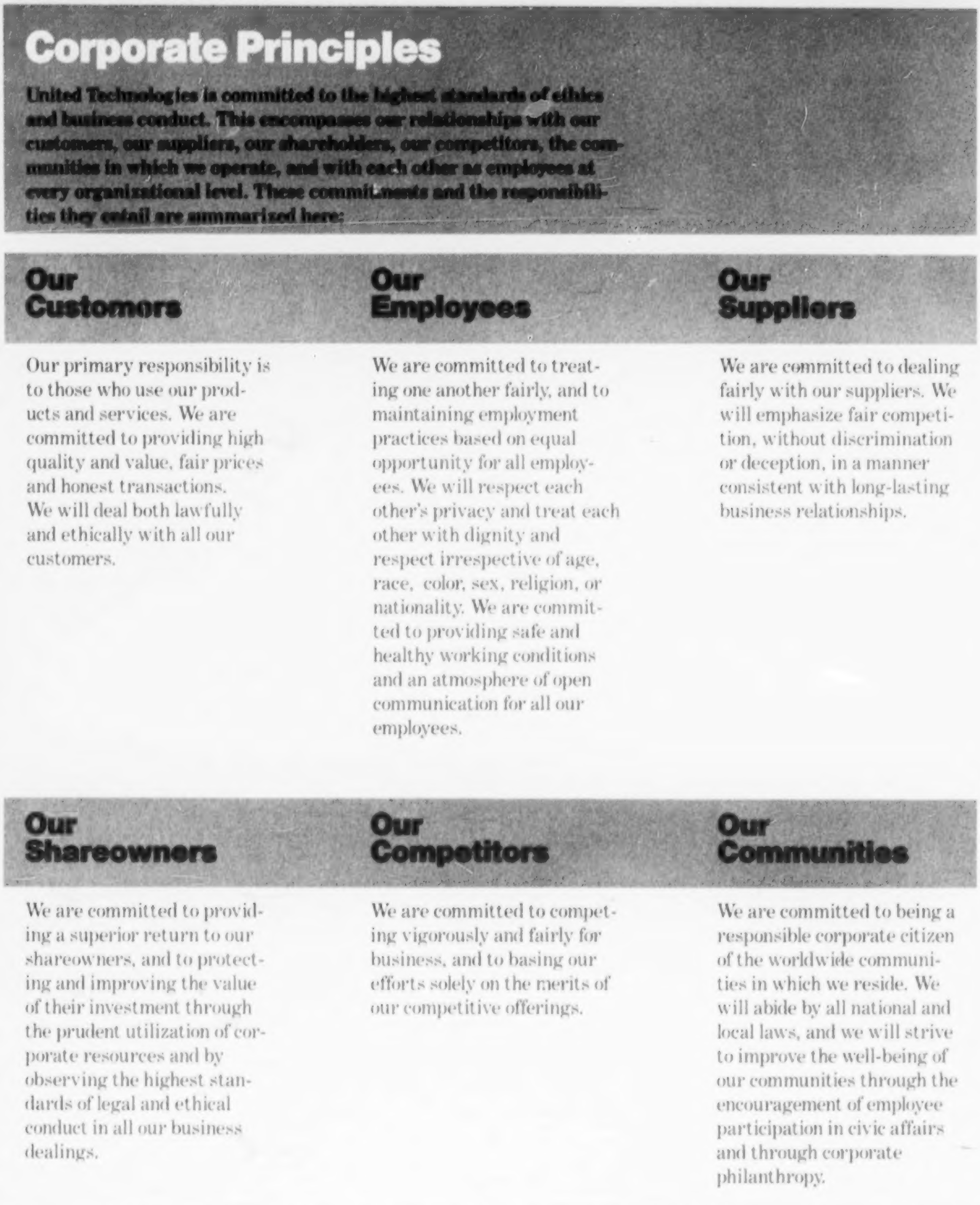
Administration of the Code

Employees are encouraged to seek guidance regarding application or interpretation of this Code of Conduct and are expected to cooperate fully in any investigation of a potential violation. The statements set forth in this Code of Conduct are intended as guidelines for employees. Routine questions of interpretation regarding the Code shall be directed to the employee's supervisory officer, and if necessary, referred to the office of the General Counsel. If any employee believes the code may have been violated, the matter shall promptly be reported to the Director of Internal Audit. Violations of the Code of Conduct may be disciplined by the Organization, up to and including dismissal. However, the Code of Conduct does not set forth all of the reasons or situations in which employees may be disciplined.

The Code of Conduct is not an employment contract, and the Organization may at any time modify the provisions of this Code of Conduct as it deems appropriate.

PROVIDENT MUTUAL
SECURITY THROUGH FINANCIAL SERVICES

Credo: United Technologies Corporation



Corporate Principles

United Technologies is committed to the highest standards of ethics and business conduct. This encompasses our relationships with our customers, our suppliers, our shareholders, our competitors, the communities in which we operate, and with each other as employees at every organizational level. These commitments and the responsibilities they entail are summarized here:

Our Customers

Our primary responsibility is to those who use our products and services. We are committed to providing high quality and value, fair prices and honest transactions. We will deal both lawfully and ethically with all our customers.

Our Employees

We are committed to treating one another fairly, and to maintaining employment practices based on equal opportunity for all employees. We will respect each other's privacy and treat each other with dignity and respect irrespective of age, race, color, sex, religion, or nationality. We are committed to providing safe and healthy working conditions and an atmosphere of open communication for all our employees.

Our Suppliers

We are committed to dealing fairly with our suppliers. We will emphasize fair competition, without discrimination or deception, in a manner consistent with long-lasting business relationships.

Our Shareowners

We are committed to providing a superior return to our shareowners, and to protecting and improving the value of their investment through the prudent utilization of corporate resources and by observing the highest standards of legal and ethical conduct in all our business dealings.

Our Competitors

We are committed to competing vigorously and fairly for business, and to basing our efforts solely on the merits of our competitive offerings.

Our Communities

We are committed to being a responsible corporate citizen of the worldwide communities in which we reside. We will abide by all national and local laws, and we will strive to improve the well-being of our communities through the encouragement of employee participation in civic affairs and through corporate philanthropy.

Mission Statement: Vulcan Materials Company

MISSION

VULCAN MATERIALS COMPANY is an international producer of industrial materials and commodities that are essential to the standard of living of advanced and developing societies.

OUR mission is to provide quality products and services that consistently meet our customers' expectations; to be responsible stewards with respect to the safety and environmental impact of our operations and products; and to earn superior returns for our shareholders.

WE recognize that success in all of our activities is related directly to the talents, dedication and performance of our employees throughout the Company.

GUIDING PRINCIPLES

INTEGRITY: We will work constantly to earn the respect and trust of all parties we interact with by acting fairly and honorably. We will observe high ethical standards and obey all laws and regulations.

EXCELLENCE: We are committed to excellence in all of our activities. We value innovation. We intend to maintain a position of leadership in each of our industries.

PEOPLE: We will maintain a high respect for people—for their dignity, their talents and their interests.

COMMITMENTS

Following are our most important commitments. They embody goals that we strive to attain and values that guide our conduct.

WE will strive to be the low cost producer in each of our industries and to be the standard-setter with regard to quality, service and technical support.

WE will respect the dignity of each of our employees and deal with them fairly. We will strive to maintain an environment that encourages them to develop their talents, exercise creativity and achieve superior performance. We will keep our compensation programs at fair and competitive levels. Employment and advancement will be based on qualifications, performance and organizational needs. We will maintain a firm commitment to employee health and safety.

WE will provide technical and educational assistance so that customers may use our products in an efficient, safe and environmentally proper manner. We will maintain a steadfast commitment to minimize any adverse impacts our activities have on the environments in which we operate. We will comply with all environmental laws and regulations.

WE will compete vigorously in each of our industries while maintaining a strict regard for compliance in all respects with the antitrust laws.

WE will be a good corporate citizen in each community in which we operate. We will support and take an active part in public and charitable projects.

WE will maintain a strong commitment to divisional autonomy consistent with high accountability and performance. Corporate and group staffs will be kept lean and highly competent so that their contributions will add value to divisional results without restricting the initiative and accountability of division managers. Corporate, group and divisional relationships will be marked by goodwill, teamwork and open communications.

WE are determined to achieve superior rates of return on the capital our shareholders have entrusted to us. We intend to rank in the top quartile of U.S. industrial companies as measured by profitability and growth in earnings. We will aggressively pursue profitable growth opportunities through extension of existing product lines, addition of new products, development of greenfield sites and business acquisitions.

Environmental Policy: Waste Management, Inc.

Waste Management, Inc.

Environmental Policy

On March 7, 1990, the Board of Directors of Waste Management, Inc. approved an expanded environmental policy for the Company.

The policy was developed and recommended by the Waste Management Executive Environmental Committee. In developing the policy, the Committee gave careful consideration to the views of environmental groups

Waste Management, Inc. is committed to protecting and enhancing the environment and to updating its practices in light of advances in technology and new understandings in health and environmental science.

Prevention of pollution and enhancement of the environment are the fundamental premises of the Company's business. We believe that all corporations have a responsibility to conduct their business as responsible stewards of the environment and to seek profits only through activities that leave the Earth healthy and safe. We believe that the Company has a responsibility not to compromise the ability of future generations to sustain their needs.

The principles of this policy are applicable to the Company throughout the world. The Company will take demonstrable actions on a continuing basis in furtherance of the principles.

Principles

Environmental Protection and Enhancement

1. The Company is committed to improving the environment through the services that we offer and to providing our services in a manner demonstrably protective of human health and the environment, even if not required by law. We will minimize and strive not to allow any releases to the atmosphere, land, or water in amounts that may harm human health and the environment. We will train employees to enhance understanding of environmental policies and to promote excellence in job performance on all environmental matters.

Waste Reduction, Recycling, Treatment and Disposal

2. The Company will work to minimize the volume and toxicity of waste generated by us and others. We will operate internal recycling programs. We will vigorously pursue opportunities to recycle waste before other management practices are applied. The Company will use and provide environmentally safe treatment and disposal services for waste that is not eliminated at the source or recycled.

Biodiversity

3. The Company is committed to the conservation of nature. We will implement a policy of "no net loss" of wetlands or other biological diversity on the Company's property.

Sustainable use of natural resources

4. The Company will use renewable natural resources, such as water, soils and forests, in a sustainable manner and will offer services to make degraded resources once again usable. We will conserve nonrenewable natural resources through efficient use and careful planning.

Wise Use of Energy

5. The Company will make every reasonable effort to use environmentally safe and sustainable energy sources to meet our needs. We will seek opportunities to improve energy efficiency and conservation in our operations.

Compliance

6. The Company is committed to comply with all legal requirements and to implement programs and procedures to ensure compliance. These efforts will include training and testing of employees, rewarding employees who excel in compliance, and disciplining employees who violate legal requirements.

Environmental Policy: Waste Management, Inc. *(continued)*

Waste Management, Inc. Environmental Policy

Principles continued

Risk Reduction

7. The Company will operate in a manner designed to minimize environmental, health or safety hazards. We will minimize risk and protect our employees and others in the vicinity of our operations by employing safe technologies and operating procedures and by being prepared for emergencies. The Company will make available to our employees and to the public information related to any of our operations that we believe cause environmental harm or pose health or safety hazards. The Company will encourage employees to report any condition that creates a danger to the environment or poses health or safety hazards and will provide confidential means for them to do so.

Damage Compensation

8. The Company will take responsibility for any harm we cause to the environment and will make every reasonable effort to remedy the damage caused to people or ecosystems.

Research and Development

9. The Company will research, develop and implement technologies for integrated waste management.

Public Policy and Public Education

10. The Company will provide information to and will assist the public in understanding the environmental impacts of our activities. We will conduct public tours of facilities, consistent with safety requirements, and will work with communities near our facilities to encourage dialogue and exchange of information on facility activities.

11. The Company will support and participate in development of public policy and in educational initiatives that will protect human health and improve the environment. We will seek cooperation on this work with government, environmental groups, schools, universities, and other public organizations.

Participation in Environmental Organizations

12. The Company will encourage its employees to participate in and to support the work of environmental organizations, and we will provide support to environmental organizations for the advancement of environmental protection.

Environmental Policy Assessment

13. The Board of Directors of the Company will evaluate and will address the environmental implications of its decisions. The Executive Environmental Committee of the Company will report directly to the Chief Executive Officer of the Company and will monitor and report upon implementation of this policy and other environmental matters. The Company will commit the resources needed to implement these principles.

Annual Environmental Report

14. The Company will prepare and make public an annual report on its environmental activities. The report will include a self-evaluation of the Company's implementation of these principles, including an assessment of the Company's performance in complying with all applicable environmental laws and regulations throughout its worldwide operations.

Environmental and Safety Operating Principles: Neste OY

NESTE

The last ten years have been a period of major change at Neste. Our operations have expanded both within Finland and overseas, through acquisitions and the construction of new production plants. Neste is Finland's largest industrial company, and in areas such as polyolefins we are now one of the six largest producers worldwide.

Nearly all of our plants involve operations which call for particular attention to be given to environmental impact and safety risks. Neste is also a major shipowner, with a reputation for a fleet designed with the special needs of shipping in arctic waters in mind. Significant environmental and safety risks are associated with transporting crude oil, petroleum products, gases, and chemicals. Similar risks are also linked with the use of many products.

Neste has long been aware of the fact that, to succeed, the Corporation must be willing to commit its resources and investments to building up its technological expertise and research capability. This principle is seen as equally important in the environmental protection area. Numerous examples of Neste's commitment to this date back as far as the early 1970s.

Society's and industry's knowledge about environmental issues is constantly growing. We have learnt, for instance, that man's burden on the environment is larger, and the environment's ability to sustain this burden smaller, than we previously imagined. For Neste, this means continually evaluating all of our activities and introducing new environmental standards. Identifying workable solutions can be difficult, as balancing the needs of production processes, energy consumption, emissions, and product properties to yield the best result in environmental terms can sometimes be far from easy.

We believe that a serious commitment to environmental protection, health, and safety represents a meaningful investment in the future, and is the only way to earn the trust of society and the users of our products. Reflecting this, we agreed a common set of environmental protection and safety standards to be observed at all Neste plants back in 1984, and a package of communications principles in 1989.

They can be crystallized as follows:

Holistic thinking

Our aim is to develop the best possible solutions in terms of the environment, occupational safety, and product user safety. In line with this, we take environmental impact and safety risks into account in decision-making on all our projects.

Responsibility

We are committed to complying with all internal and external regulations, and observing good working practices. Areas of responsibility must be clearly defined at every level within the Neste organization, and written instructions available for all procedures in our day-to-day operations.

An active approach

Environmental impact and risks are the subject of constant study at Neste. The expertise which we build up in these areas is applied throughout our planning, target-setting, and decision-making activities.

Taking the initiative

We follow developments in our fields closely. Our aim is to be one step ahead of what legislation requires in developing new products and applying the latest advances in research.

Openness

We fully accept the right of society and individuals to know. We provide comprehensive information on our activities, and are always ready for dialogue.

Guiding Principles: The Great-West Life Assurance Company

Corporate Mission

We believe that most people need measures of employer-sponsored and individually initiated financial protection and services, quite aside from benefits provided by government, to assure their financial well-being and the financial well-being of their families and the businesses with which they are associated.

Our mission is, therefore, to achieve excellence in providing financial products and services for people, and to do so in a responsible manner.

We will accomplish this mission through creative anticipation of and response to the changing needs and preferences of our clients.

Principles of Personnel Management

We will maintain [illegible] and respect for, the dignity of the individual. We will strive to select and retain superior people. We will build and maintain a dynamic organization through an open and participative style of management that encourages teamwork at all levels of the company. We will give staff members and sales personnel every opportunity to make the most of their abilities and reward them according to their contribution to meeting our objectives.

Corporate Objective

Our objective is to achieve increasing acceptance of our products and services, measured by long-term real growth in our assets, premium income and fees for services.

An equally important allied objective is to earn operating income sufficient to provide:

- the best possible net cost for clients
- a competitive return on the equity invested in the business and real growth in net income attributable to shareholders.

Principles of Marketing Management

We will distribute our products and services in the best interests of our clients through distribution systems that are contemporary, innovative and socially responsible.

In this context, we reaffirm our belief that incentive commission systems reflect sound and enduring marketing management principles.

We will also use other means of marketing to access markets insufficiently addressed by established systems.

Principles of General Management

General management will operate the company with contemporary and enlightened principles and processes.

Major emphasis will be placed on the co-ordination of operations and optimal employment of resources to achieve the company's Mission and Objective.

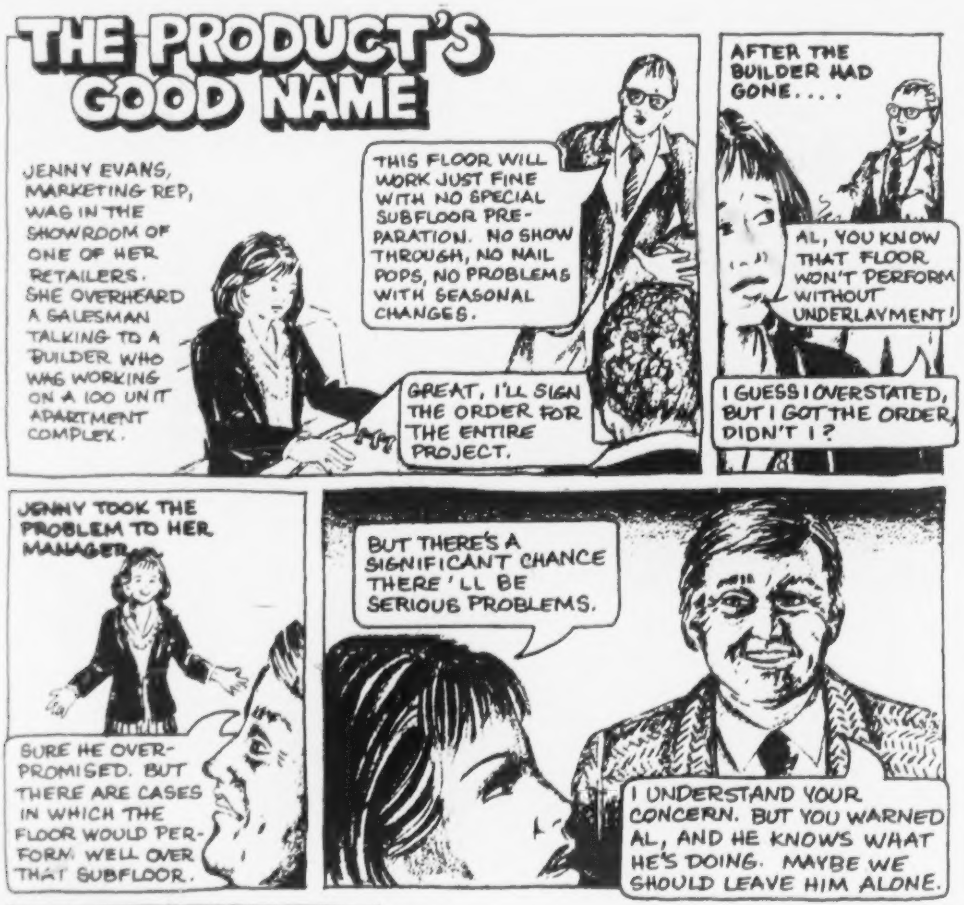
Great-West Life's management recognizes that to prosper, the company must serve its clients, staff members and sales representatives, shareholders and the community at large, with integrity and according to the highest standards of conduct.

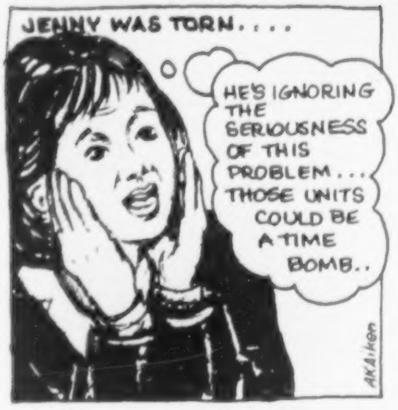
Principles of Investment Management

Our investment program will carefully balance the quality, term and rate of return on our investments. We will strive to achieve a consistently superior rate of return to meet our overall financial objectives and obligations to our clients.

Ethics Training Materials: Armstrong World Industries

This cartoon strip, which presents an illustrative, hypothetical ethics situation in cartoon form, was used by Armstrong World Industries, Inc. in "ethics awareness" seminars conducted for its employees.


THE PRODUCT'S GOOD NAME
JENNY EVANS, MARKETING REP, WAS IN THE SHOWROOM OF ONE OF HER RETAILERS. SHE OVERHEARD A SALESMAN TALKING TO A BUILDER WHO WAS WORKING ON A 100 UNIT APARTMENT COMPLEX.
THIS FLOOR WILL WORK JUST FINE WITH NO SPECIAL SUBFLOOR PREPARATION. NO SHOW THROUGH, NO NAIL POPS, NO PROBLEMS WITH SEASONAL CHANGES.
GREAT, I'LL SIGN THE ORDER FOR THE ENTIRE PROJECT.
AFTER THE BUILDER HAD GONE....
AL, YOU KNOW THAT FLOOR WON'T PERFORM WITHOUT UNDERLAYMENT!
I GUESS I OVERSTATED, BUT I GOT THE ORDER, DIDN'T I?
JENNY TOOK THE PROBLEM TO HER MANAGER...
SURE HE OVERPROMISED. BUT THERE ARE CASES IN WHICH THE FLOOR WOULD PERFORM WELL OVER THAT SUBFLOOR.
BUT THERE'S A SIGNIFICANT CHANCE THERE'LL BE SERIOUS PROBLEMS.
I UNDERSTAND YOUR CONCERN. BUT YOU WARNED AL, AND HE KNOWS WHAT HE'S DOING. MAYBE WE SHOULD LEAVE HIM ALONE.


JENNY WAS TORN....
HE'S IGNORING THE SERIOUSNESS OF THIS PROBLEM... THOSE UNITS COULD BE A TIME BOMB..
AKAikon

1. **How is Armstrong's reputation affected by a retailer's misrepresentation? How could Armstrong be affected by Jenny taking action? not taking action?**

2. **If you were Jenny, what would you do and why: talk or write again to the retailer? raise your concerns with the Division staff in Lancaster? ignore it?**

Setting and Meeting Ethics Program Objectives: Westinghouse Electric Corporation

1990 PLAN

In 1990, the Ethics Office will develop an Ethics Refresher Agenda that will reinforce to all employees the Corporate Standards of Conduct and the genuine support from top management. The Ethics Program Plan also includes development of a more effective communications program for the article and poster campaigns, for all Westinghouse locations doing business with the Department of Defense.

The Ethics Program for 1990

	J	F	M	A	M	J	J	A	S	O	N	D
Communications												
Articles	△		△		△		△		△		△	
Annual Report		△										
Best Practices Forum						△ Meeting			△ Report			
Training												
As Developed												
Posters		△		△		△		△		△		△
Coordinator Feedback												
Meetings			△						△			
Reports				△			△			△		△
Price Waterhouse				△ 1989 Recommendations				△	—	△ 1990 Audit		
Employee Feedback Survey					△	—	△					
Refresher Training Module Development												
Reformatted Code						△						
Q/A Booklet								△				
New Video										△		
Annual Reminder Letter											△	
Plan for Annual PIC												△

(continued on next page)

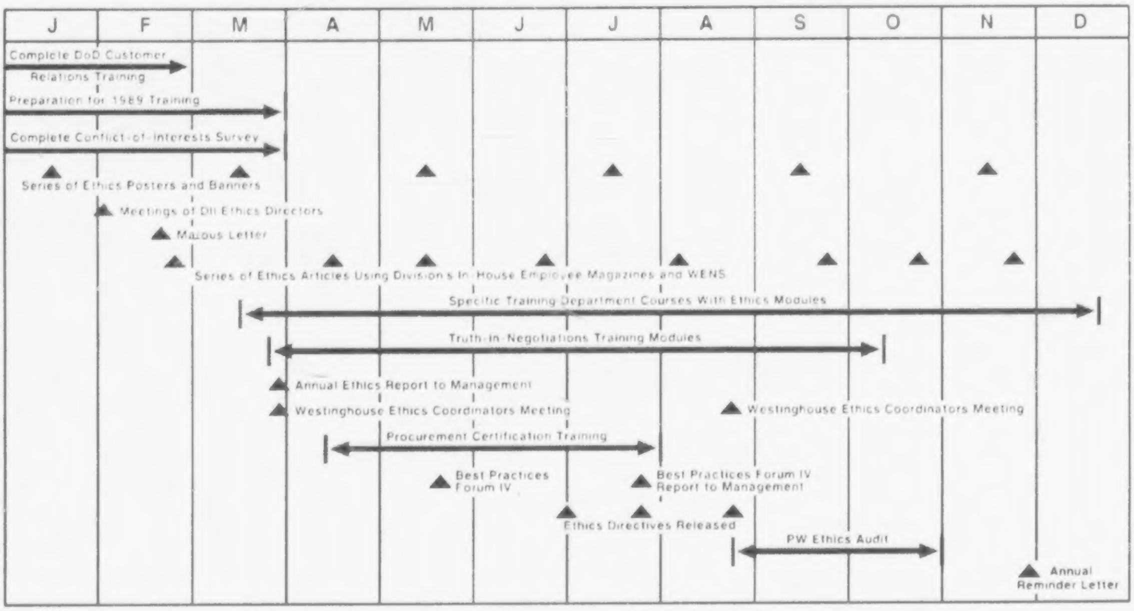
Setting and Meeting Ethics Program Objectives: Westinghouse Electric Corporation *(continued)*

1989 ETHICS PROGRAM OBJECTIVES MET

The goals and objectives for each phase and activity of the Ethics Program were successfully met in 1989. As a major defense contractor, Westinghouse Electric Corporation has taken an active role in implementing its Ethics Program in both the spirit and intent of the Defense Industry Initiatives. The Corporation's reputation for quality products and integrity has contributed immensely to its continued success and sustained growth in the complex world of defense contracting.

Westinghouse employees consistently attain this goal by following policies detailed in the Westinghouse Code of Business Ethics and Conduct.

The Ethics Program for 1989



Related Publications

Corporate Stewardship of The Environment, Report No. 982, 1991

Corporate Ethics: Developing New Standards of Accountability, Report No. 980, 1991

Employee Privacy, Report No. 945, 1990

Safeguarding Intellectual Property, Report No. 925, 1989

Corporate Ethics, Report No. 900, 1987

External Challenges to Management Decisions: A Growing International Business Problem, Report No. 808, 1981

The Conference Board
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The Conference Board

Report Number 987

The Emerging Role of the Work-Family Manager

Research on more than 70 companies with a designated work-family manager shows:

- *dramatic job growth will continue*
- *the heart of the job is management, not service delivery*
- *communicating the business case is an ongoing task*
- *the future of the job is change management*

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About The Conference Board

Founded in 1916, The Conference Board's twofold purpose is to improve the business enterprise system and to enhance the contribution of business to society.

To accomplish this, The Conference Board strives to be the leading global business membership organization that enables senior executives from all industries to explore and exchange ideas of impact on business policy and practices. To support this activity, The Conference Board provides a variety of forums and a professionally managed research program that identifies and reports objectively on key areas of changing management concern, opportunity and action.

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The Emerging Role of the Work-Family Manager

by Arlene A. Johnson and Karol L. Rose

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EXHIBITS: JOB DESCRIPTIONS

25 1. Bank of America, Manager — Work/Family Programs
26 2. John Hancock, Family Care Issues Consultant
28 3. Times Publishing Company (St. Petersburg Times), Work & Family Resource Counselor
30 4. Xerox Corporation, Manager, Life Cycle Programs and Policies

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Karol L. Rose is Manager, Work & Family Programs/ Training for Time Warner Inc. and a frequent presenter at work-family conferences. Prior to joining Time Warner, Ms. Rose launched one of the nation's first employer-supported child care consulting firms and co-authored *The Employer's Guide to Child Care*. She is a member of The Conference Board's Work and Family Council.

Authors' Acknowledgments

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From the President

Issues such as flexible work schedules and child care needs are no longer considered "soft" human resource concerns; they are fast becoming the "hard" issues of the '90s.

More and more companies are designating a work-family manager to develop policies and programs designed to help employees remain productive while meeting their family responsibilities. This report analyzes the emergence, responsibilities, qualifications and outlook for the work-family position.

The Conference Board is grateful to the many companies and individuals who shared their experience and insight. We especially thank Time Warner Inc. for its active and visible support of this research.

PRESTON TOWNLEY
President and CEO

Executive Summary

Until recently, the role of work-family manager was non-existent. But during the past two years several hundred firms have designated such an individual to develop, coordinate and promote the company's expanding work-family policies and programs. The rapid growth of the position raises practical questions about how to define and structure the job as well as about qualifications and career opportunities for individuals who have the job.

The appointment of a work-family manager is usually an outgrowth of needs assessment and program development. Companies designate a work-family manager to give consistency and focus to work-family programs and to formalize the company's commitment to work-family concerns.

The primary responsibilities of the job are programmatic (e.g., issue analysis, policy design and program implementation). Change management and organization development are also important, since work-family managers are expected to build support for the new programs they develop. Incumbents stress that the most pervasive and challenging part of the job is in defining and communicating the business case for work-family programs.

The primary customers of the work-family manager are management and employees: management wants work-family initiatives linked to the bottom line; employees' needs may be addressed directly through counseling or indirectly through policy development. To meet the challenge of geographically dispersed employees and multiple business units, work-family

Method

The research for this report consisted of four components: focus groups, a questionnaire, a compensation survey and supervisor interviews.

Focus groups: In spring 1991, 32 work-family managers participated in focus group discussions held in New York City and Los Angeles. The discussions explored the managers' experiences in the work-family position, similarities and differences in how the job is structured in different companies, and perspectives on the evolution and future of the work-family position.

Questionnaire: Surveys were distributed in August 1991 to a sample of 116 work-family managers. The 68 respondents (a 59 percent response rate) provided detailed information on job responsibilities, reporting relationships, staffing patterns, job credentials, and organizational and personal priorities for their companies' work-family programs.

Compensation survey: Using a specially developed compensation survey instrument, 32 companies provided information on salary ranges and compensation levels for work-family managers with comparable job responsibilities.

Supervisor interviews: Telephone interviews were conducted with a random sample of 18 executives to whom work-family managers report. Each executive was interviewed about the reasons for establishing a work-family manager position, the pros and cons of having such a position, and the future of the work-family manager job in their company.

Additional information came from presentations and discussion groups at the first national conference for work-family managers, held in Chicago in November 1991 and cosponsored by Work/Family Directions, the Boston-based consulting and employer services organization, and the Families and Work Institute, a nonprofit research and planning organization based in New York City. Background information and insights were also provided by participants in the December 1989 meeting of Boston University's Work and Family Roundtable and by the 35 members of The Conference Board's Work and Family Council.

managers try to involve local and regional managers in sharing the responsibility for programs.

The work-family job may be structured as a full-time or part-time position. It is usually located within the human resource department and is compensated at a middle-management level. Though employee benefits and work-family programs are usually separated functionally, work-family managers tend to feel that there would be benefits in closer collaboration.

Incumbents in the work-family manager job have diverse educational and job experiences. Experience in child care and social service qualified some candidates for the job, but, in general, management experience predominates as a qualifying criterion. Of graduate degrees awarded to incumbents, 65 percent are in management. Over half of incumbents have experience in human resource management.

Several kinds of skills have proven valuable in the job. Strong communication and interpersonal skills are required for the influencing, negotiating and spokesperson aspects of the job. Planning skills and knowledge of the organization are necessary for assessing the company's needs and tailoring programs to fit those needs.

The popularized image of a work-family manager is that of a social worker or child care expert who counsels employees and provides direct services to help employees solve their work-family conflicts. The reality is of a business manager, committed to organizational goals, competing for resources, and heavily involved in planning, communication, negotiation and program development.

Work-family managers value the visibility and influence that their job provides, and they appreciate the opportunities for creativity, experimentation and risk-taking that the newness of the job affords. Most regard the job as a positive career step, but, at the same time, they wonder whether the job is properly valued and if it will present future career opportunities.

In the next few years the number of work-family managers will continue to increase, and the focus of responsibilities will shift from program development to organization development. Consistent with the goal of institutionalizing work-family awareness, more effort will go toward managing change, dispersing work-family responsibilities throughout the organization, and creating synergy with other functions and business objectives.

The work-family manager position is proving to be an effective way for a company to channel resources to work-family objectives. The question for the future is whether the position can also change company culture and institutionalize work-family awareness.

A New Job

> *"Purpose: To establish a designated, corporate position to support and enhance the company's commitment to provide an environment, policies, and programs that enable employees to maximize productivity in their employment by successfully balancing responsibilities associated with both work and family."*
>
> *—from "Proposal to Establish a Work-Family Issues Position," submitted July, 1991, Fortune 50 company*

The role of work-family manager, much less the title, was virtually non-existent five years ago. Today, several hundred firms in the United States have created a work-family manager role—and the numbers are increasing monthly. In spring 1991, at The Conference Board's Work and Family Conference in New York City, 40 percent of attendees said their companies have a work-family manager. The dramatic emergence of this new human resource function reflects the fact that helping employees balance work and family is increasingly seen as a business issue.

A growing number of employers are focusing on the reciprocal impact of work and family responsibilities and its implications for productivity, recruitment and retention. For example, many companies have implemented dependent care assistance programs and flexible work arrangements. A study of 188 of the Fortune 500 companies found that 55 percent provide child care resource and referral, 48 percent offer job-sharing arrangements, and 55 percent offer elder care consultation and referral for employees.[1] In response to a 1990 Conference Board survey, human resource executives said that, of all recruiting incentives, family-supportive programs and flexible work arrangements would increase most in importance over the next few years.[2]

To coordinate, direct and evaluate the growing number of work-family policies and programs, many companies are designating a specific person to oversee all the company's work-family initiatives. The title varies from company to company, as does the amount of time dedicated to the role. However, since there is enough similarity in the purpose and content of these jobs, the people who hold them are becoming known as work-family managers. In this study, a work-family manager is defined as someone who has specific, assigned responsibility for developing and/or implementing work-family policies and programs.

Need for Information — What Is This Job?

The rapid emergence of the work-family manager position raises questions both for companies and incumbents who hold the job. In addition to evaluating the merits of establishing this position, companies are asking how to structure and position it within the organization. Incumbents find themselves pioneering a new field without the benefit of a well-established peer network or the kind of job guidelines available for most other human resource functions.

The purpose of this study is to enable executives and work-family managers to benefit from the experience of over 70 companies that have defined and assigned work-family responsibilities. For organizations, it will help evaluate the concept of a work-family manager, identify options for structuring and staffing a work-family position, and examine present practices and trends. For individual work-family managers, many of whom say that shaping their own job is one of their greatest challenges, the study provides perspectives on how the work-family manager role is evolving and how it is defined by peers and other companies. The final section of the study analyzes the prospects for a specialized work-family role within human resources and makes recommendations for companies that plan to establish this kind of position.

Rapid Growth

The job of work-family manager has evolved rapidly. Sixty percent of study respondents said their

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[1] Families and Work Institute, *The Corporate Reference Guide to Work-Family Programs*, 1991.

[2] See "What Incentives are Important for Recruiting Employees?" in *Rethinking Employment Security*, The Conference Board, RB 244, 1990.

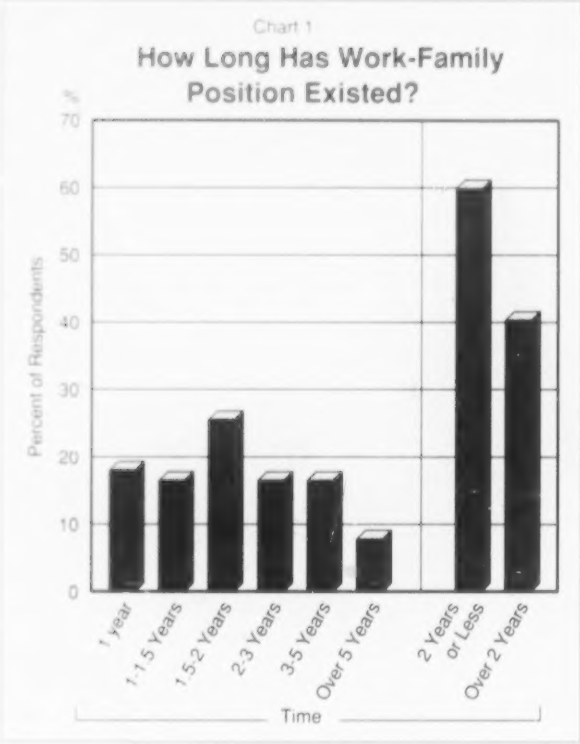
Chart 1
How Long Has Work-Family Position Existed?

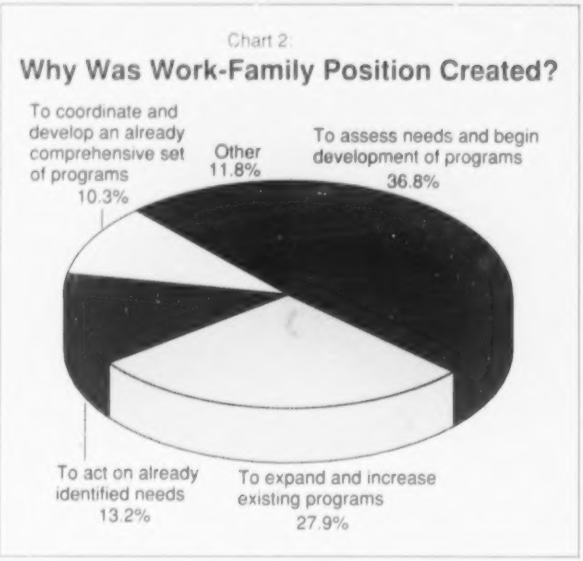
Chart 2:
Why Was Work-Family Position Created?

company designated "work-family responsibilities" as a position or set of responsibilities within the last two years. For one-third, the job was created in the last 18 months. Only 8 percent of the respondents are in positions that existed for more than five years (see Chart 1). These figures may understate the percentage of new positions because the study sample was deliberately skewed to include more experienced work-family specialists.

Work-family managers report feeling challenged and rewarded by the newness of their position and the opportunity to define and develop their role. But the newness also creates frustration and uncertainty. Reflecting on more than three years directing work-family programs, one respondent observes: "What's most challenging about my job is also the most exciting part of it—that I'm really making it up as I go along. Sometimes there are days when that's really wonderful, and then there are times when it's difficult because I'm not sure where it's going."

Why the Position Is Established

Asked why their company designated a work-family manager, executives name two primary motivations: (1) to create a focus for communication and action and (2) to embody the company's commitment to work-family concerns. Having someone dedicated to developing, researching and implementing programs, it was felt, would enable the company to move more aggressively—to answer the burgeoning number of employee requests and to implement programs equaling those of competitor companies. It would also provide consistency and continuity in dealing with employees' and managers' policy questions. As a Midwestern executive summarizes: "In order to realize the company's vision of being a high-quality, well-managed company, we created the position to formalize the company's support of these issues."

Naming a work-family manager is usually not a company's first initiative; rather, it is the outgrowth of previous needs assessments and program development, often conducted by a task force, employee committee, or a work-family champion who effectively defines the issues and recommends programs. Establishing a separate position or set of work-family responsibilities indicates the company has, to some degree, already recognized that work-family concerns are important to the business. The majority of survey respondents say their job was established to expand and increase existing programs and to act on already identified needs (see Chart 2). About one-third of responding companies established the position to assess needs and start programs.

Prior to creating a work-family manager position, a company typically goes through a process of raising awareness and developing a few programs. As the programs grow, the need for coordination becomes evident. One manager describes the evolutionary process: "At first work-family issues come up in various places (in the company). You do as much as you can without having someone designated as the person. Then it gains some credibility and someone says: 'We need someone to be in charge.'" Another manager observes: "You know, we had people working on this long before we had anyone with the role. But at some point the company felt they needed someone to own it, to be the champion, the advocate, to carry the responsibility, to keep track."

Components of a Work-Family Program

A work-family initiative may consist of a few programs or of many integrated policies and programs. The following is a list of programs that may fall within the responsibility of a corporate work-family manager. Each program or policy would include tasks related to design, development, implementation, communication, training and evaluation.

DEPENDENT CARE

- On- or near-site day care center
- Contract for slots in outside centers
- Sick or emergency care services
- School age child care programs
- Resource and referral services
- Dependent care spending account
- Vouchers or financial subsidies
- Information on dependent care tax credits
- Adoption assistance
- Summer or school vacation programs
- On-site public schools
- Family day care network
- Public or private consortia and partnerships
- Peer support groups
- Information seminars for parents/caregivers
- Training for dependent care providers
- Guidebook to selecting dependent care services
- Prenatal education for expectant parents
- Development fund for dependent care initiatives

FLEXIBLE WORK ARRANGEMENTS

- Part-time employment
- Personal days
- Flextime
- Flexplace
- Telecommuting
- Job-sharing
- Compressed workweek
- Phased retirement
- "Voluntary" time
- Gradual return to work

LEAVE PROGRAMS

- Family/medical leave (paid and unpaid)
- Personal leave of absence
- Family illness days
- Sabbatical
- Excused family days
- Respite leave
- Bereavement leave
- Leave bank
- Leave sharing

OTHER

- Corporate work-family task force
- Work-family needs assessments/employee attitude surveys
- Relocation policies: spouse employment assistance and family counseling
- Work-family training for managers
- Work-family policy handbook: guidelines for managers and employees
- Work-family resource center
- On-site information fairs

Work-family programs often are linked to or work collaboratively with other corporate-sponsored programs. A work-family dimension frequently is identified in the following:

- Employee assistance programs
- Cafeteria or flexible benefit programs
- Long term care insurance
- Health/wellness programs
- Stress awareness/reduction workshops
- Corporate foundation giving
- United Way campaign drives
- Union/management negotiation team or review committee
- Work force diversity programs
- Total quality management initiatives
- Sexual harassment and equal opportunity issues
- Community relations
- Public affairs and legislative monitoring

Realization of the wide range of activities involved in developing a comprehensive work-family program may be the stimulus for creating such a position (see box, above). For one diversified firm headquartered in the Midwest this is how it happened: "We had an in-house task force and one of their recommendations was to hire (a work-family manager). Before that it was nobody's job. They saw it was everybody doing a lot of little pieces."

Defining the Job

> *"The job is always evolving. Sometimes it's predictable and sometimes it's not. One challenge is making things work in so many different locations, but the biggest challenge is strategic. How do you use work-family programs in a strategic way to meet the needs of the employee population and also to get management support and involvement?"*
>
> *—work-family manager, diversified service company*

The job of work-family manager usually has several distinct components that include assessing needs, analyzing emerging issues, developing and maintaining relevant work-family programs, developing and implementing company communications, and managing outside vendors and external communications. The content of the job focuses on making the workplace a better, more sensitive environment for employees to balance work and family responsibilities—not only by developing appropriate programs and policies but also by building support for these policies.

The newness of the position, as well as the field itself, encourages managers to create, design, develop and experiment. As an evolving role, the work-family manager position is being shaped by the expectations of management and employees as well as by the priorities of incumbents themselves.

Primary Responsibilities

Using a list of responsibilities that surfaced in focus group discussions, 68 work-family managers identified the responsibilities that they—and their bosses—agree are part of their job. Each one then identified the three most important roles. The summarized results show general agreement that the job is primarily one of program and policy development and implementation with a heavy emphasis on communicating, positioning and marketing programs both internally and externally (see box).

The expectation that work-family managers will "make new things happen"—that they will not only design and implement programs but also build support for them—contributes a strong organizational development aspect to the job. This is evident in job descriptions (see Exhibits, pages 25-30) and even more pronounced in the words work-family managers use to describe themselves: "trendsetter," "bridge builder," "network-creator," "model builder," and "caretaker of the issues." Work-family managers often describe activities in terms of gaining influence and interfacing with a broad range of "customers" to create change. "A lot of this is brokering," says one. Another elaborates: "I call it influence and brokering. My boss calls it a flyover. You take

Roles of the Work-Family Manager

Role	*"Part of my job"*	*"One of my three most important roles"*
Program designer	94.1%	30.9%
Employee advocate	91.2	7.4
Internal consultant	89.7	25.0
Program implementer/ coordinator	88.2	29.4
Program advocate/ champion	88.2	26.5
Internal marketer	86.8	11.8
Community liaison	82.4	8.8
Researcher—data gathering	82.4	10.0
Strategic planner	79.4	26.5
Manager of vendors	77.9	8.8
Policy planner	77.9	23.5
Spokesperson	77.9	8.8
Issue analyst	75.0	29.4
"Lightning rod"—focal point	73.5	7.4
Trainer	70.6	8.8
Change agent	69.1	20.6
Employee counselor	64.7	2.9
Financial controller/ budget manager	57.4	4.4
Service deliverer	39.7	4.4
Other	11.8	2.9

a snapshot of the organization and see what's going on and where some of the deficiencies are relevant to where you think they should be and then you identify the needed changes. What's involved is getting those changes implemented by beginning to map out strategies with the decision-makers."

Though they have responsibility to identify and advocate for employees' needs, work-family managers are not, for the most part, responsible for providing direct assistance to individual employees. "Service delivery" was named least often as a job responsibility. Managing service delivery, however, is an important part of the job. In the area of child care and elder care, for example, the work-family manager usually selects, evaluates, and provides the liaison with the vendors that deliver information and referral services to employees.

Management's Expectations

Creating a work-family position conveys an expectation that the number and reach of work-family programs will grow, will be monitored and administered efficiently, and will be consistent with the company's work-family commitment.

Beyond programmatic expectations, senior managers look to the company's work-family manager to define and communicate the business argument for work-family programs. Establishing a work-family manager position is a statement about the business importance of work-family issues. To justify and support that statement is part of the job. A newly appointed manager explains: "They really want to be sure that if they've gone out on a limb to create my job, that there's going to be some benefit. Either it's going to save the company money or we're going to get a higher rating on my client survey—something tangible."

Management also wants to make sure that work-family initiatives are linked to the bottom line. The work-family manager must continually make the business case for work-family programs and develop cost justifications to support them.[3] As one manager expresses it, her senior management is looking for a business partner who will put the cost and benefit of work-family issues in a strategic context: "What we're really trying to do is respond to the needs of the business not just for today but for 5, 10, 15 years from now—to become the employer of choice....Our senior managers are looking for that business partner who can respond to a business issue—to say 'Boy, do I have a [work-family] opportunity for you, and here's the cost justification for doing it.'"

Education and consciousness-raising are also part of the job. One recently designated work-family manager understands that her senior management wants her to be a change agent, to make sure that the company's commitment to comprehensive programs gets appropriate attention and is really implemented throughout the organization: "I guess my job is to always bring it up, consciousness raising, you know...to be the watch dog...to keep track of it and not let it get lost...to make sure work-family isn't left out of a business discussion when someone else might not think to bring it up."

Employee as Customer

While counseling employees is not usually a large part of the job, staying in touch with employees' experiences is. For this reason, many work-family managers make time to answer employees' concerns. One respondent says: "Even though direct service is not part of my job, it's my research base and it tells me what's warming up." Another explains: "I don't want to let go of my counseling hat completely because that's my meter; that's my feed of information. It's like an ongoing needs assessment." The volume and urgency of employee questions often steals time away from more 'official' responsibilities; one manager admits, "counseling employees takes more time than my supervisor could begin to comprehend."

To stay in touch without becoming involved in time-consuming counseling, one experienced work-family manager has regular conversations with the employee relations staff who takes phone calls from employees: "That keeps me in the loop. What I need to understand are some of the trends and particulars to get a feel for what the problems are. I don't need to touch it directly."

Sometimes work-family managers play the role of ombudsperson, mediating issues that arise between employees and their managers: "People come to me if they get bumps and bruises talking to their management about flexible schedules, for example. I will suggest their manager can call me and maybe I can explain something. That is how I want to be viewed—as a resource person." Another manager adds: "Our job is to support the employee—but through the managers."

In companies that have a designated work-family position, employees are usually aware and pleased that it exists, whether or not they personally benefit: "I hear a lot from employees that they're glad someone's looking after these issues," says one manager. "It makes them feel that the organization is all right because it's got this representation."

Multi-Site Responsibilities

The size and geographic distribution of employee populations poses a challenge. "How do I manage...to reach all of our field people?" asks one manager. "We have a base of 18,000 that are close to me and I can reach them by modern communication methods, but the rest of the 50,000 people are spread out all over the country. I have a real responsibility to reach them as well, and it's difficult because they're in 225 different places, and my staff is small."

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[3] See *Linking Work-Family Issues to the Bottom Line*, Report No. 962, The Conference Board, 1991.

The work-family managers in this study have responsibility for a median population of 12,000 employees in 30 different sites (see Chart 3). Some develop policy and program only for corporate headquarters or specific divisions, but two-thirds have responsibility for the entire company. Employee needs, community resources, the level of management commitment, and even existing policies may differ from site to site. The challenge is to design, develop, and expand programs in a way that takes into account diverse regional and business unit needs as well as diverse employee populations.

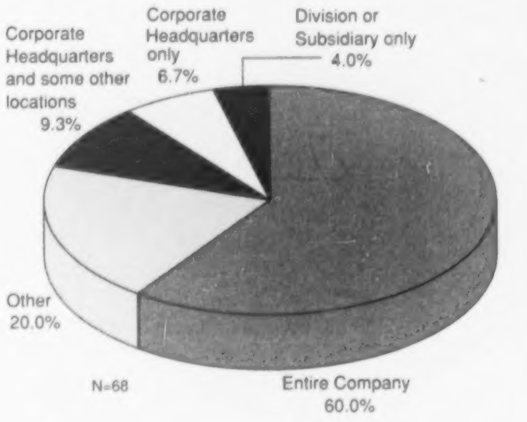
If the company is decentralized, the challenge is even greater. For example, at the highly decentralized Time Warner company (media and entertainment), the work-family manager creates detailed model programs that business units can adapt for their own needs. At Hewitt Associates (consulting) senior management looks to the work-family manager to create a "national umbrella" of policies and procedures that serve as a base for local implementation. At Baxter Healthcare (health care supplies and services), divisions must implement the core work-family policies, but each division determines the implementation timetable and reviews aspects of the policy in light of business needs. At Avon (cosmetics), varied local response is part of the national strategy: "We have various management teams that clear with this concept differently, depending on how they see it in relation to their own business plan. Some places serve as the pioneers, and we're moving forward at different speeds across the United States."

As noted earlier, an important part of the job is consulting with local and regional management. The work-family manager is expected to provide consistent answers on a range of questions from administration of adoption assistance to interpretation of family leave policies. But there is a danger that consulting directly with line managers may undermine the goal of creating ownership of work-family issues at the local level. Therefore it is often preferable to train local resource people. "On more than one occasion," says the work-family manager of a diversified corporation, "a division has said, 'Come out and talk to our managers.' But I purposely stay away from that because I don't want the ownership, and that is not going to change the culture. I think the whole point is to get the people involved who can make the difference...the local human resource people."

To extend their reach, many work-family managers have a network—formal or informal—that shares some work-family responsibility. Sometimes members of this network are clearly designated. At Dow Chemical (chemicals, plastics and consumer goods), for example, each major division has a family issues coordinator or someone—perhaps with a human resource generalist, benefit or diversity title—for whom work-family responsibility is part of the job. BP America (oil) has a task force composed of a human resource representative from each of the business groups. Functioning as a work-family development team, the task force acts jointly to assess needs and develop strategies and programs. However, not all work-family networks are so clearly defined. One company, for example, has a work-family liaison person in each division. But, according to the work-family manager: "While some are actively involved, others simply distribute material."

Chart 3:

Scope of Work-Family Responsibilities



Number of employees responsible for:
Range: 300 - 260,000
N=65 Median: 12,000

Number of sites/locations responsible for:
Range: 1 - 999
N=53 Median: 30

Number of divisions, subsidiaries responsible for:
Range: 1 - 250
N=40 Median: 9

Are there other people in the company with similar responsibilities?
Yes 42.6%
N=61 No 57.4%

In nearly 60 percent of cases, the work-family manager is the only person in the company with assigned work-family responsibilities and therefore relies on other types of support within the organization. As one respondent explains: "To make a difference, you need to find partners." Sometimes EAP and benefits personnel are recruited to help deliver services and explain policy. Most often, however, it is the local human

Chart 4:

What Percent of Time is Given To Work-Family Responsibilities?

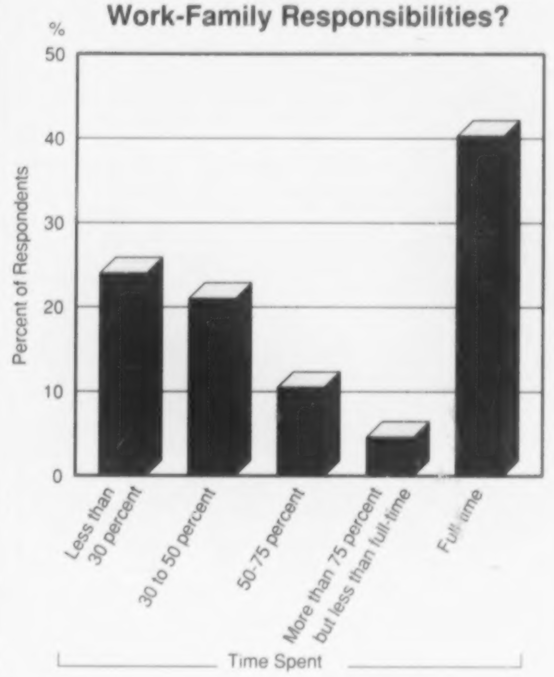
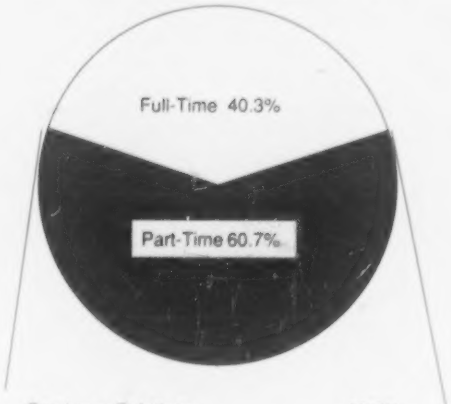


Chart 5:

What Else Do Part-Time Work-Family Managers Do?



Employee Relations	33.8%
Communications	23.5
EEO/AA	20.6
Employee Assistance	20.6
Other	20.6
Recruiting/Staffing	13.2
Community Relations	11.8
Training	11.8
Benefits	7.4
Compensation	2.9
Corp. Foundation/ Contributions	2.9

Total is more than 100% due to multiple answers.

resource staff that is targeted, not only to communicate and implement policies but also to broker work-family issues and build relationships with field offices. The work-family manager may sponsor seminars or training sessions to involve and educate human resource staff and help them communicate the business rationale for work-family programs.

Structuring and Positioning the Job

Part-Time or Full-Time

People with work-family responsibilities are almost equally divided between those who do the job part-time and those who are full-time work-family managers. One-quarter spend 30 percent or less of their time on work-family. However, for 40 percent it is a full-time job (see Chart 4).

The longer work-family responsibilities have existed in the company, the more likely it is that the job is full-time. This may suggest that pioneering companies who first established the position had a greater commitment than some companies that have come to the issue more recently. Or, more likely, it suggests that as programs and awareness build within a company the need for a full-time position gains credibility and support.

For those who are not full-time work-family managers, other responsibilities cover a range of human resource functions (see Chart 5). Employee relations, communications, EEO/AA and employee assistance are the human resource functions paired most often with work-family responsibilities.

Reporting Structure

Positioning within human resources is also reflected in reporting relationships. Nearly half the responding work-family managers report to a human resource executive with generalist responsibilities. Seventeen percent, eight percent and three percent report to employee relations, EEO/AA/Diversity and communications respectively.

Relationship to Employee Benefits

It is interesting that only 8 percent of work-family managers report to the employee benefits department, even though many dependent care programs were originally perceived and packaged as benefits. One work-family managers recalls: "When we first began our [work-family] initiative, I felt it was most appropriate [to be located in] benefits because they had all the resources I needed." Another adds that, in her company, association with benefits gave work-family a solid base: "A lot of people understand what benefits are so it helped formalize the program."

When work-family initiatives expanded to include flexible work schedules, management training and culture change, the objectives of the program expanded beyond a traditional view of employee benefits. "What we're trying to get across is that work-family is not a benefit per se," explains one work-family manager. "It really is a lot more."

Despite the functional separation from benefits in most companies, there is a prevalent feeling that work-family programs and the benefits function should be more connected. Policies on flexibility and parental leave, for example, should not be seen exclusively as a work-family responsibility. "We shouldn't have ownership of those policies," says one work-family manager. Another company respondent agrees: "[Work-family policies] should be integrated into the culture and integrated into...the benefit package. Everyone in benefits should be able to answer parental leave policy questions, not just the work-family person."

Xerox Corporation and Mobil Corporation offer examples of comprehensive work-family programs that are positioned under the employee benefits umbrella. Cross functional and cooperative efforts between work-family programs and employee benefits are likely to become more common as the definition of benefits continues to expand to include compensation, wellness, life-cycle planning, and quality of life issues.

Title and Status

"It's very important that you report to a senior-level person who can give you the backing you need," observes a work-family manager. "It's a sign of the importance of work-family if you are reporting to the executive level in the organization." In general, work-family managers report to upper-middle or senior management. Seventy percent of survey respondents report to someone with the title of "vice president" or "director."

As for their own titles, respondents are divided almost equally between directors, managers and coordinators (see box, below). The titles themselves vary greatly and in some cases are defined by the part of the job that is not work-family related.

Staff Assistance and Compensation

Two-thirds of respondents report having some kind of staff assistance, most of whom are full-time employees. Of those with staff, most manage one or two people (see Chart 6, page 16).

A separate compensation survey of jobs with comparable work-family responsibilities shows that compensation rates are consistent in most parts of the country

Sample Titles of Work-Family Managers *

Coordinator/ Counselor/Consultant

- Work & Family Resources Counselor
- Family Resource Consultant
- Family Care Issues Consultant
- Work & Family Coordinator
- Family Issues Coordinator
- Coordinator, Child and Elder Care Referral Service
- Administrator, Work/Family Programs
- Senior Administrator/Family Benefits
- Senior Program Officer/ Employment Equity

Supervisor/ Manager

- Manager, Work & Family
- Manager, Work & Family/ Training Programs
- Manager, Work/Life Strategies
- Manager, Work/Home Programs
- Work Force Diversity Manager
- Manager, Diversity Issues and Programs
- Employee Relations Programs Manager
- Manager, Human Resources Systems Development
- Manager, Organization Development and Quality of Life
- Manager, Benefits/Training & Development

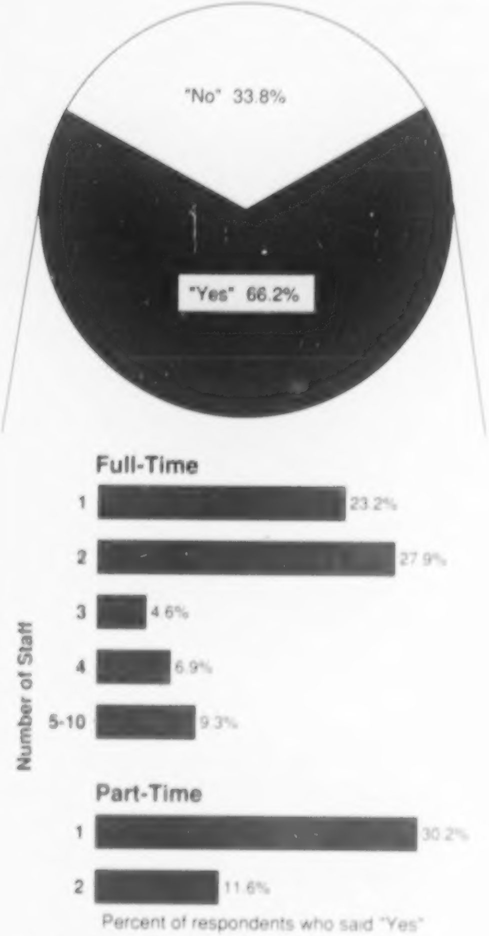
Director/ Vice President

- Director, Work & Family
- Director of Family Services
- Director, Work/Family Initiatives
- Director, Dependent Care
- Director of Employee Relations
- Director, Corporate Human Resources Services
- Director, Workforce Diversity
- Director, Personnel Policies
- Director, Public Affairs
- Vice President and Manager, Work/Family Programs
- Vice President, Policy and Program Development

*** Work-family manager refers to someone who has defined responsibilities for work-family issues or programs as part of the job description. Though the designation varies (e.g., work-family, work & family, work/life), the content of the field is generally understood to deal with balancing family and job responsibilities.**

Chart 6:

Do Work-Family Managers Have A Staff?



Total equals more than 100% because some respondents have both full-time and part-time staff

and that work-family managers are compensated in the middle-management range (see box, page 17). The job is too newly defined, however, to conclude that present compensation practices will be the trend for the future.

Incumbents' Priorities

Incumbents agree that at this point their primary responsibilities are programmatic—program design, implementation and issue analysis. Program design involves setting priorities and deciding how to put work-family objectives into action. One manager explains: "Senior management signed off on high-level recommendations. Now it's my job to decide what we really mean by them and how to implement them." Another manager agrees: "The challenge is how to focus and how to set priorities because there are so many options and opportunities. My job is the nitty-gritty of putting it all in place."

Work-family managers feel responsibility for expanding the quantity and reach of work-family programs. This includes putting more emphasis on elder care, workplace flexibility, and work-family training for managers. To develop programs, they want to attract more resources—both staff and budget—and work more in collaboration with other functions.

In a list of official responsibilities, programs receive top priority. But in conversation and personal comments, work-family managers assign even greater importance to their change agent and program advocacy role. They say that defining and communicating the business case for work-family programs is the most important and pervasive part of their job. "I market 99 percent of the time," says one. Another manager summarizes what she learned in her first year on the job: "At first when I made presentations to manager groups, I made the wrong assumption that I should explain the programs. I learned my lesson. I needed to forget the programs and concentrate on the reasons for them. Otherwise I was asking people to do something they didn't understand the purpose of."

A manager with more than four years' experience in work-family programs concludes that the essence of the work-family manager job is stimulating new levels of awareness and understanding. "The communication and selling is always what's going to be most challenging," she says. "My job is always going to focus on what people haven't said yes to. My role is moving people to the point where everybody says, 'Oh yes, of course, why wouldn't you?'."

Compensation Structure for Work-Family Managers

Method

During spring and summer 1991, 32 compensation directors completed a survey on compensation levels for the work-family managers in their companies. To determine the average compensation levels for similar positions, companies compared their position to a model job description (see below). Of this group, 21 companies said the job description was a good match with the position in their companies.

Job Description: Manager, Work and Family Programs

Summary Description: Manage the work-family function within the organization with work-family responsibilities occupying 50 percent or more of the position.

Responsibilities:

- Develops, implements, maintains and evaluates work-family programs within the organization for either single or multiple locations
- Designs, implements and disseminates information about work-family programs and policies
- Creates a communications and marketing process which includes distributing information on work-family programs and policies to employees
- Represents the company as a spokesperson or media contact on work-family issues
- Identifies, contracts with and monitors various vendors and services for issues such as child and elder care resource and referral services, employee assistance programs, child care, etc.

Compensation

Of the 32 companies providing information, 29 (90.6 percent) use salary ranges to determine minimum and maximum salaries.

Using the midpoint of the salary scales provided by the 21 companies with similar job descriptions, the average national salary was calculated as $56,138. Using the same method, average salaries were also calculated for six geographic regions: New England, Metropolitan New York, Mid-Atlantic, Southeast, Midwest, and West Coast. The average salary in most geographic regions was remarkably close to the national average, but deviations of approximately 25 percent above and below the national average were calculated for the Metropolitan New York and Midwest regions respectively.

Bonuses

In an even half of the 32 companies surveyed, the work-family position is bonus eligible. The largest single group is eligible for a bonus of 6 to 10 percent of annual salary. The group was equally divided above and below the 10 percent bonus level.

Bonus Range (in percent)	*Number of Respondents*
1 - 5%	1
6 - 10	7
11 - 15	5
15 or more	3

Effect of Work-Family Responsibility on Salary

Since work-family is an emerging field, questions have been raised about the impact of work-family responsibilities on human resource professionals' compensation levels. Thirteen companies provided information on the effect of job responsibilities on salaries. Of these, nine companies reported that the work-family manager's salary is determined solely by the work-family responsibilities of the job, not by the incumbent's personal experience. In the remaining four companies, responsibilities other than work-family not only determine the salaries but have the effect of driving compensation upward. It seems that work-family responsibilities do not increase compensation levels compared to other human resource functions and may, possibly, be less compensated than other human resource positions at comparable levels. As the position becomes more defined and more common, this situation may change.

Profile of a Work-Family Manager

"We got over 150 résumés for the director position of work-family and did not find one single soul to fit that position. I could literally put the résumés into two piles. Half of them were business and half of them were social workers, and there was nobody that had both sides of the coin. I think you have to be kind of a renaissance person, pragmatic and clear-minded about the organization's development and also knowledgeable about the people side of work-family."

—manager, work and family life,
West Coast human services organization

Work-family managers come from diverse educational and job experiences, but they have in common a cluster of skills and a positive view of their job.

The formal education of work-family managers is extremely diverse, ranging from degrees in mathematics, anthropology, economics, marketing, dance, journalism, medical research and history to areas that may seem more directly related to the work-family field—education, sociology, psychology, health management systems, human resource management and counseling. Of the work-family managers surveyed, 71 percent report having a bachelors degree, of which slightly over half are in areas directly related to the content of the work-family job: 32 percent in business and 27 percent in social work (see Chart 7).

Business degrees predominate among the 51 percent of respondents who earned graduate degrees. Combining MBAs with other masters degrees in business subjects (e.g., marketing, organizational development), 65 percent of graduate degrees awarded to respondents are in business and management.

Work-family managers' job and organizational experience are also diverse. Almost 60 percent of incumbents come to the work-family position from a human resource background. Their past jobs are a variety of human resource and personnel functions including manager of EEO, employee relations officer, human resource generalist, relocation manager and benefits consultant. The other 40 percent of incumbent work-family managers come from a variety of non-human resource fields, including marketing, data management, public affairs, corporate contributions, and corporate communications—as well as teaching and social service positions. Of those with child care and social work backgrounds, many had already made a career change into a business or human resource role before they got the job of work-family manager.

For some, the work-family manager position is a way to capitalize on a diverse background or "repackage" their non-business experience. Says one: "I actually see this as related to what I was doing 20 years ago in the guise of social policy—helping the organization change in response to changes in its constituencies, needs, expectations and values. In this case I am specifically focusing on the needs of the employee constituency." Another observes: "When I got a degree in Family Studies in 1979, my father said 'What are you going to do with that?' Well, for 10 years I did electrical engineering because there was nothing related to my field. The time wasn't right; now the time is right."

An analysis of job histories shows that many work-family managers come to the position with more than six years experience in management. In their previous job, which respondents held on average for 3.3 years, 50 percent had a vice president, director or manager title. In the job previous to that, which was held on average for 3.1 years, 39 percent of respondents were at a manager or director level.

In general, work-family managers are hired from within the company. Of those surveyed, three-quarters were identified for the job through an internal hiring or posting process; one-quarter were hired from outside. The predominance of internal hires may be a result of the interest and competition within the company for the job. It probably also reflects companies' preference for people who understand the organization and its culture.

The Selection Process

Sometimes there is very little competition for the work-family job. Almost 13 percent of respondents as-

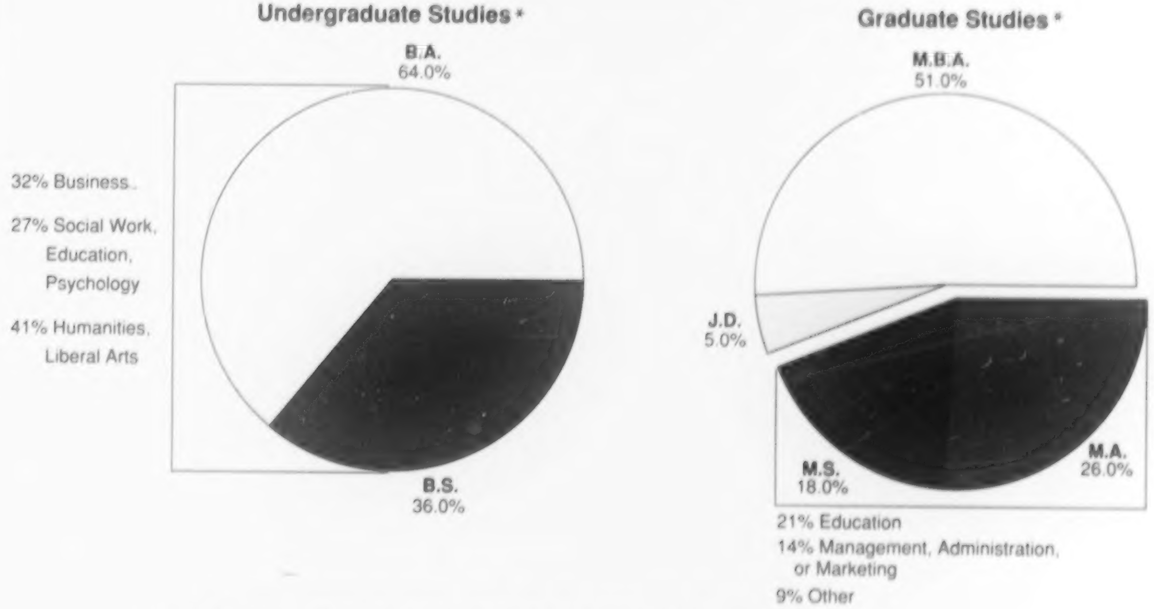


Chart 7:

Education of Work-Family Managers

*71% of respondents report having undergraduate degrees (This does not include those who have earned associate degrees or other educational backgrounds.) 56% report having graduate degrees. 3% earned doctorates.

sumed the job after having already performed it informally; "No one ever wrote a job description. No one ever said we've got to recruit for this." More typically, however, there is a great deal of interest when a work-family position is created. "When this job was announced in our company, they had 60 postings. It was the most interesting area in which to have a job."

Selection criteria for the work-family job reveal a good deal about the nature of the position and how it is perceived. Several themes emerge from respondents' comments about the skills and experiences that influenced their selection for the job (see box). For some, knowledge of work-family issues and programs was the decisive factor. These people cite experience with corporate child care task forces, child care centers, parent education programs, or research for dependent care policy development. Others say long-time interest in work-family issues made them the most visible candidate for the job; about 15 percent of respondents had been visible champions of work-family issues within the company. Still others cite their own personal experiences with child care and elder care as giving them an understanding that helped to qualify them for the job.

A track record as a successful manager is the qualification cited most frequently in making a person the number one candidate for the work-family job. Especially valued in the selection process are management

"What I Look for in My Staff"

When work-family managers add people to their staff, this is the kind of person they look for.*

- A self-starter
- Able to influence people, politically skilled
- Has line experience and/or human resource background
- Able to deal with subtle resistance
- Has good relationship with managers
- Flexible, comfortable with variety and able to switch gears
- Can think conceptually
- Has good writing and speaking skills
- Is considered "promotable," high potential
- Depending on the task...program designer, researcher, knowledgeable about content area (e.g., child care)

* Desirable qualities for work-family staff members were identified and discussed at the first national conference of work-family managers, held in Chicago, November 1991, cosponsored by the Families and Work Institute and Work/Family Directions.

and communication skills related to starting a new program—the ability to influence, knowledge of the issues, and familiarity with the organization. Many respondents credit their reputation as producers and self-starters: "I was not the lead candidate for this role, but I think what put me over was that…they thought I was a person who knew how to start the job up from nothing; I was autonomous." Another manager echoes this feeling: "I had a track record in start-up operations. I really think the start-up experience was what they were looking for."

Skills for Success

Typically, work-family managers must be able to influence a wide variety of constituents inside and outside the organization, manage multiple projects, and set long-term priorities. More specifically, work-family managers say they have found four kinds of experience and skills most valuable:

Communication skills. Writing policies, procedures, newsletters and proposals, making presentations, giving speeches, listening and counseling, and acting as spokesperson and internal consultant all require good communication skills. Communication is also vital for the influence and negotiation aspects of the job: arguing the issues persuasively and winning support for policies.

Planning and strategic thinking. Organization and planning—at both the project and strategic level—are critical for handling the many aspects of the job. Research and analytical skills, as well as creativity, are important for assessing corporate needs and tailoring programs.

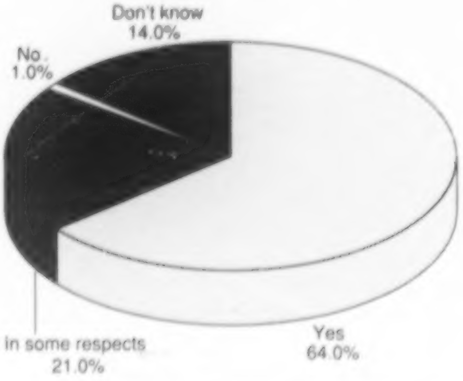
Knowledge of the organization. It is valuable to understand corporate culture, company policies, the nature of the business, the organization's long-range plan, and the major "players" in management, unions and operating units. This helps identify needs, get pilot programs initiated, and establish personal credibility in the organization.

Interpersonal skills. Good human relations skills—including patience, empathy, judgment, and diplomacy—help to create the kind of networks essential for leading and influencing at many levels of the organization.

Though commitment, perseverance and risk-taking are not formal selection criteria for the job, these qualities are evident in the operating style of many work-family managers. Many agree with this manager's assessment: "[The job is] finding ways to get ideas and programs in front of the right person in the right way at the right time…and to keep it alive. You need incredible perseverance and persistence and you have to keep networking…and don't worry about risk-taking. Stick your neck out and take your chances."

Chart 8:

Has The Work-Family Job Been A Positive Career Step?



There is a learning value, say incumbents, in having personal experience with child care, elder care or family counseling. Certainly one must become knowledgeable about the programmatic elements of the job. But most important are good management skills and knowing how to influence the organization.

A Career Path?

Work-family managers feel positive about their job but uncertain about its long-range career implications. They value their visibility and influence in an area of growing importance. Some even say they have "the best job in the company." At the same time, they have concerns about whether the job is properly valued.

Some wonder if over-identification with one issue could reduce career opportunities. Others think it is too soon to know just how this new role will affect incumbents' promotability. Over 60 percent, however, believe their work-family responsibilities have been a positive career step, primarily because the job usually entails high visibility both inside and outside the organization (see Chart 8). Interfacing with many groups provides more opportunity for influence than many comparably positioned middle-management jobs. Explaining her decision to leave another position and accept the work-family job, one manager explains: "I figured I could make more of a difference in this job. I mean, the whole company is my client group…There's a lot of opportunity to make it go the way I want it to go."

The change management, problem-solving and strategic planning aspects of the job provide both excitement and, many believe, transferable skills. "It's like a microcosm of what's happening in corporate America. All the management and leading-edge issues are being played out in the work-family vocabulary," exclaims one manager. In the same spirit another observes: "In 5 or 10 years we will look back and say 'I did this, and that's what helped me get where I am.'"

Experienced managers point out that visibility has its limits. Opportunities for personal visibility often need to be curtailed in order to extend ownership of the issues. "To be effective," contends one manager, "sometimes you need to park your ego at the door." Moreover, in companies where work-family programs are not a priority, recognition may be lacking.

Most work-family managers today are women. In part this reflects women's predominance in human resource middle management. But it may, some fear, reinforce an erroneous perception that work-family issues only affect women. Another concern is that if women dominate the field it will be devalued both in compensation and influence. Many feel, however, that the work-family field offers women an unusual opportunity to demonstrate management and strategic skills in an area in which they have both insight and commitment.

In the long run, the career opportunities of the work-family position will be linked to how the position evolves within the human resource function.

Outlook and Recommendations

"Discussion about the role of the work-family manager isn't really about a separate new function or specialty. It's about a way to refocus our human resource activities. We need a voice for work-family issues to help us see who our employees are today and what they need to be productive."

—Director of diversity and work-family issues, Fortune 50 company

Companies that appointed work-family managers report that this move has been a positive one. Work-family managers as well as executives to whom they report say the position has contributed focus and consistency to work-family efforts. It has also resulted in expanded and new programs, and allowed the company to be more proactive—both with employees and external constituencies—than would otherwise have been possible. With a range of issues vying for corporate attention and program resources, having a dedicated resource accountable for policy and program implementation has helped companies pursue their objectives in the work-family area.

The goal of work-family initiatives, however, is not just to expand programs. For optimal impact on the bottom line, work-family concerns must be incorporated into the company's and its managers' behavior. The key question for the future will be: "Does having a work-family manager help an organization institutionalize work-family awareness? Or does it prevent others from taking ownership?" "There is always the danger," observes one executive, "that when you vest someone with a title, others divest themselves of the issue." As summarized by one incumbent, ultimately, the work-family manager's role should be "to make everyone a work-family manager who thinks about and integrates flexibility and work-family awareness in everyday operations."

Some suggest the work-family manager job is a transitional role that will disappear when commitment to work-family programs is more widespread. Many companies believe, however, that the role will gain increased importance. Among executives interviewed who supervise work-family managers, the large majority—say that in the next few years the work-family manager's responsibilities will be expanded and gain status. Most do not anticipate adding work-family managers at the division or regional level, though some hope to increase the staff of the current manager. This is true for companies that have comprehensive programs as well as for those with farther to go. In the words of one executive: "Ideally, the position will phase itself out because the company's mindset will embrace the work force and there will be no need for this position. However, this isn't going to happen soon."

New Directions

Experience to date, as well as the observations of executives and work-family managers themselves, suggest that in the next few years four trends will characterize the evolution of the work-family manager role.

(1) The number of companies designating work-family managers will continue to grow. In part this is because the demographic and competitive factors that motivated the increase in work-family managers in the past few years will continue and accelerate. Moreover, having a work-family manager is rapidly becoming an expected component of serious work-family initiatives.

(2) The education, change management and organization development aspects of the job will become increasingly important. Already this aspect of the role is clear to many incumbents. As companies develop comprehensive work-family policies, the focus will shift to management training and culture change. The work-family manager's job will move from implementing and fine-tuning new programs to promoting systemic culture change.

(3) Responsibility for work-family programs will be dispersed more widely, especially through the network of human resource representatives. The work-family manager will work with task forces, work-family committees, senior management and the human resource organization to transfer ownership and responsibility for work-family issues. The role of the

Recommendations for Structuring a Work-Family Manager Position

Anticipated trends, as well as experience to date, suggest a number of guidelines for structuring a work-family manager position.

- **Prior to appointing a work-family manager, establish the company's need for and interest in work-family issues.** A task force recommendation, needs assessment or statement from senior management is needed as a base of support for the position.* Having some preliminary programs in place is also helpful.
- **Communicate the existence of the position throughout the company.** Explain the job in the context of business needs. Give the position visibility and relate its purpose to the strategic plan of the business.
- **Make the position accountable to an influential part of the organization.** Since an argument can be made for various reporting streams, the job should be organizationally located where there is strong support for work-family issues.
- **Position the job for influence.** At a middle-management or executive level, the work-family manager should have autonomy, decision-making power, and access to senior management.
- **Choose the person for the job carefully, emphasizing management, communication and strategic planning skills.** Credibility with the rest of the organization is critical.
- **Establish clear lines of communication and support with human resource staff in divisions and regional sites.** Create a plan for educating and involving them in program implementation.
- **Plan for and establish channels for cooperative relationships with other functions**—such as employee benefits, labor unions, and employee assistance programs—as well as with other corporate initiatives in total quality management and diversity management. Senior-level support for these linkages will foster synergy and prevent turf battles.
- **Designate and train other staff for counseling employees and answering their specific questions on work-family policy.** One-on-one counseling is time-consuming and should not be allowed to take time away from the work-family manager's strategic and organizational issues.
- **Size resources appropriately for the scope of the job, remembering that the field is dynamic and growing.** To avoid making the job an add-on responsibility, evaluate carefully the possibility of a full-time position.

* For a detailed discussion of the ways that companies structure task forces and focus executives on work-family needs, see *Family-Supportive Policies: The Corporate Decision-Making Process*, Report No. 897, The Conference Board, 1987.

work-family manager will increasingly be as a resource and facilitator to help managers themselves implement and communicate work-family issues.

(4) **Linkages with other functions will become more important.** In addition to maintaining connections with employee relations, training and communications, work-family managers will be expected to work more collaboratively with the staff of employee benefits, wellness programs, community relations, quality initiatives and work force diversity programs. In some companies the "work-family" vocabulary may even be subsumed under the umbrella of quality or diversity efforts.[4] For companies that are establishing a new position or modifying an existing job definition, this research points to several recommendations (see box, above).

The Challenge

The constantly changing social and business environment brings new issues to the fore that demand a place on the corporate agenda. Whether the issue is total quality management, environmental protection, or reconciling work and family responsibilities, companies must evaluate the issue's importance and then determine the response. They must first decide what resources should be assigned to addressing it and, ultimately, how the company's response can become an integral part of the corporate culture. Thus the work-family manager position has emerged rapidly in the past few years as a way to focus resources on an issue of growing importance to human resource management. It remains to be seen how well companies can integrate work-family awareness into mainstream business operations.

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[4] For a discussion of conceptual and programmatic linkages with quality and diversity, see *Strategies for Promoting a Work-Family Agenda*, Conference Board Report No. 973, pp. 13-15.

Exhibit 1: Job Description

BANK OF AMERICA

POSITION: MANAGER - WORK/FAMILY PROGRAMS

Responsibilities:

- ***Policy Analysis.*** Review existing company policies in light of changing employee and business needs; develop new policies or policy revisions; take policy proposals through the decision-making process to obtain management approval; analyze local, state, and federal legislation and propose company positions.
- ***Program Development.*** Design new programs responsive to employee needs; take program proposals through the decision-making process to obtain management approval.
- ***Implementation.*** Design and manage process for introducing approved policy and program proposals: internal communications, staff training, systems changes.
- ***Communications.*** Produce a monthly newsletter for HR staff on latest developments in field; develop articles and brochures for employees on work/family matters; critique drafts of speeches and video scripts with work/family content.
- ***Consultation.*** Provide advice and counsel to managers and employees dealing with work/family conflicts; serve as subject matter expert on diverse HR projects.
- ***Committee Leadership.*** Chair 12-member Work/Family Steering Committee; prepare issues papers for monthly meetings.
- ***Representation.*** Represent the company as a member of external task forces, networks, coalitions, councils, etc.; respond to inquiries from the media, other businesses, government officials, educators, students, and private individuals; give speeches; testify at legislative hearings.

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Exhibit 2: Job Description

JOHN HANCOCK

TECHNICAL/PROFESSIONAL JOB DESCRIPTION

I. JOB TITLE: FAMILY CARE ISSUES CONSULTANT

Reports to: Senior Vice President

II. JOB FUNCTION

To be an advocate for family care issues—research evolving issues and programs, implement recommendations, direct employee communications—be a public spokesperson, develop, coordinate and administer corporate programs, measure effectiveness of programs and monitor the operation of the John Hancock Child Care Center.

III. UNIT FUNCTION

To support the Company's commitment to provide an environment and policies that are supportive to John Hancock employees achieving a balance between work and family issues.

IV. JOB DUTIES

1. Participate as a member of the Child Care Center Implementation Task Force during the development of the center. Monitor the operation of the John Hancock Child Care Center. Approve policies (enrollment, tuition, services) and quality assumptions and participate in the system for parent/consumer feedback, the Parent Representative System. Initial enrollment in the center will be 100 children. Direct expansion to 200 children in the next year.

2. Research evolving family care issues and programs such as, national referral services for elder care and child care, alternate work schedules, work at home, etc. Keep abreast of both state and federal current legislation which will impact John Hancock Family Care policies. Develop, recommend and implement new programs to deal with ongoing issues within the organization.

3. Develop and coordinate "Kids-to-go" program with a Boston-based non-profit Child Care Center, to provide special activity programs during several of the school holidays and vacation weeks for school age children of John Hancock employees.

4. Oversee the Massachusetts Child Care and Elder Care Services. Serve as the liaison with the referral agencies assuring the quality and timeliness of the contracted services provided to John Hancock employees. Negotiate and approve annually cost and types of services provided by agencies.

5. Collaborate with the H.R. Training Unit to include family care issues sensitivity training into the Corporate Managerial Development Program. Assist in the training of managers on how to be supportive and positive in dealing with employees with family care issues.

6. Develop and coordinate annual 2-day "Summer Care" fair at John Hancock. Invite providers of summer vacation camps and programs to attend a trade show where they can provide employees and the public with information regarding summer camps and programs in New England.

7. Act as a Company spokesperson both internally and externally on family care issues. Direct employee communications. Develop educational series on family care issues. Serve as the primary information source for the Company regarding family care issues in operation within the Company.

V. JOB DATA

1. Describe responsibility for making or suggesting changes to policies and/or procedures:

X Effects changes

___ Approves changes

X Makes recommendations

___ Other ______________________________

___ Participates on committee to recommend changes

___ Participates on committee to approve changes

2. Work performed directly affects the Company's:

X Public image

___ Sales

X Other Ability to attract + retain qualified employees in a shrinking labor market.

___ Overall planning (company-wide)

X Other departments or divisions

3. Internal/external contacts:

X Other divisions/departments

X Field clerical staff

___ Policyholders/clients

___ Agents/brokers

X General public

___ Other ______________________________

X Consultants

X Other insurance companies

X Vendors

X Regulatory agencies (SEC, IRS, etc.)

4. Impact on Company funds/resources:

X Recommends purchases (equipment, materials, etc.)

___ Authorizes funds to make purchases/pay bills

___ Has custody of funds such as cash, securities and checks

___ Is responsible for the accounting of Company funds

___ Commits Company to financial liability (e.g., underwriting risk approval, claim payment authorization, loan commitments)

___ Processes funds (checks for premium payment, loan payments)

___ Other ______________________________

VI. SKILLS AND ABILITIES

Broad, up-to-date knowledge of Company's dynamic organizational structure and personnel policies and procedures. Strong oral and written communication skills are critical to this position. Excellent interpersonal skills in order to deal effectively with internal and external contacts. Proven project management skills and the ability to work independently. Sound personal judgment and initiative required. Excellent analytical skills for needs assessments. Minimum of a Bachelor's degree with 3-5 years experience in child care/elder care services field required.

Exhibit 3: Job Description

TIMES PUBLISHING COMPANY (ST. PETERSBURG TIMES)

TITLE: WORK & FAMILY RESOURCE COUNSELOR

DEPARTMENT: PERSONNEL

PURPOSE OF POSITION:

Responsible for researching, developing and maintaining programs to facilitate the dependent care needs of staffers and their families.

RELATIONSHIP RESPONSIBILITIES:

Supervision Received

Receives general supervision from the Personnel Manager.

Internal Relationships

Coordinate with department managers and supervisors regarding individual staffer needs.

Coordinate the production of communication materials.

Communicate with the Personnel staff for information about staff needs and individual situations.

Coordinate through Corporate Marketing the development of communication materials about family programs.

Coordinate the interdepartmental Work & Family Resource Advisory committee.

Work with the advisory committee members on programs to address the needs of departments and staffers.

Use staff members as resources for family workshops.

Establish data base on absenteeism and sick time related to family issues with Accounting, Research and Computer departments.

Communicate annual Flexible Spending Plan enrollment.

External Relationships

All counties, with company locations, licensing boards and/or the Florida Department of Health & Rehabilitative Services for lists of child care providers.

ProjectLink for information on other employer-sponsored child care initiatives.

Member of the Pinellas County Task Force on Child Care for Mildly Ill Children.

Area Agencies on Aging for current information on resources for the elderly.

Child care centers near company locations.

Companies within the community in regards to child care.

United Way and their agencies within the communities.

Accounting and consulting organizations for communication on regulatory changes.

Professional experts on issues to address in workshops and also other community sources to address dependent need issues.

Other newspapers for information and views.

Accounting firm handling — Flexible Spending account.

PERSONAL RESPONSIBILITIES

Maintain continuous contact with all relevant county child care licensing boards for accurate and current lists of child care providers.

Develop and coordinate a parental network within the company.

Develop and coordinate working parent and adult children seminars on issues addressing family needs.

Contact child care providers and negotiate for extra or different hours, emergency care, etc. to meet staff needs.

Work toward increased community options for care of mildly sick children.

Provide specialized information as necessary to company and departments in regard to child care, elder care, use, costs, etc.

Write communication materials dealing with the child care and elder care policies and earned dividends.

Pursue feasibility of company-operated child care facility or consortium with hard data for possible positive or negative solution.

Become and remain completely informed on company policy as it pertains to dependent care issue and earned dividends.

Participate with the Personnel staff at other Personnel office locations to provide staff information.

Assist in annual United Way campaign with Services Coordinator.

Perform additional Personnel Department duties as assigned.

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Exhibit 4: Job Description

XEROX CORPORATION

MANAGER, LIFE CYCLE PROGRAMS AND POLICIES

1. Develop strategy to enable employees' work life and private life to integrate into a corporate culture that maximizes human resource potential and productivity to achieve business results. Design strategy for development of work and family programs and policies.
2. Manage operations and update of existing programs and policies.
3. Manage implementation of new programs and policies.
4. Manage interface for policies and programs deployment in operating companies.
5. Establish measurements for all programs/"suppliers."
6. Establish interface and integration of programs with other benefits (e.g., EAP with health care plans and programs).
7. Maintain benchmarking process and efforts.
8. Manage corporate responsibilities for relocation programs and policies.

Scope:	$6 million direct
	$50 million shared
Staff:	1 Exempt
	.5 Non-exempt

Related Conference Board Publications

Long Term Care: A New Employee Benefit? Research Report No. 981, 1991

Strategies for Promoting a Work-Family Agenda, Research Report No. 973, 1991

Linking Work-Family Issues to the Bottom Line, Research Report No. 962, 1991

Work and Family Policies: The New Strategic Plan, Research Report No. 949, 1990

Relocating Two-Earner Couples: What Companies Are Doing, Research Bulletin No. 274, 1990

Flexible Staffing and Scheduling in U.S. Corporations, Research Bulletin No. 240, 1989

A Life Cycle Approach to Family Benefits and Policies, Perspectives No. 19, 1989

The Countdown on Family Leave, Perspectives No. 18, 1989

Family Supportive Policies: The Corporate Decision-Making Process, Report No. 897, 1987

Corporations and Families: Changing Practices and Perspectives, Report No. 868, 1985

Corporate Financial Assistance for Child Care, Research Bulletin No. 177, 1985

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The Conference Board

Report Number 997

Restricted Stock for Employee Motivation, Reward and Retention

A study of 172 U.S. companies finds:

- *use is increasing*
- *more linkage to performance measures*
- *restricted stock used to retain executives, high potential employees, and those with special skills*
- *programs recognize and reward special achievements*

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To accomplish this, The Conference Board strives to be the leading global business membership organization that enables senior executives from all industries to explore and exchange ideas of impact on business policy and practices. To support this activity, The Conference Board provides a variety of forums and a professionally managed research program that identifies and reports objectively on key areas of changing management concern, opportunity and action.

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Restricted Stock for Employee Motivation, Reward and Retention

by Elizabeth R. Arreglado and Charles Peck

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From the President

Executive compensation has been undergoing considerable scrutiny recently from the media, some shareholder groups, and certain academics and legislators. Some feel that executive pay is often excessive and unjustified by firm performance. One area criticized is restricted stock, which involves grants of company stock to executives subject to restrictions against sale or transfer for a period of years.

The present study reveals that, increasingly, companies are using concrete measures of performance to govern the receipt of restricted stock by executives. These performance measures often relate to the long-term financial success of the organization. By counterbalancing short-term compensation, including salary and annual bonus, restricted stock focuses executives' attention on the long-term prosperity of the enterprise.

We are grateful to the executives who contributed their time and expertise to this study.

PRESTON TOWNLEY
President and CEO

Terms

Grant: An award of restricted stock.

Gross-up: Company provides an amount sufficient to pay participant's income tax due on a restricted stock grant.

Long-term performance unit/share plan: Contingent grants of cash (units) or stock (shares) are *awarded* to an employee. Eventual *payment* depends on achievement of multi-year financial performance goals.

Restricted stock: Shares of employer stock granted to an employee subject to restrictions on sale and transfer.

Restricted stock option: Right to purchase shares of restricted stock.

Restricted units: Numeric representations of shares of stock that are subject to restrictions.

Spot award/instant incentive: Special grant of restricted stock to an employee for a noteworthy achievement.

Vesting: Point of time when restrictions on previously granted shares of stock lapse.

Executive Summary

Economic recession, continual restructuring and intense competition for global markets drive corporations to find ways to enhance long-term prosperity.

One step toward achieving this is to increase top managements' commitment to long-term growth. Executive compensation programs help reinforce this commitment. These programs include stock options, long-term performance plans, and, the subject of this report, restricted stock.

Since the 1960s when they first became generally used, grants of stock restricted from sale or transfer for

Method

Information for this study was collected during September and October 1991. Questionnaires were mailed to 2,000 U.S. companies. Those surveyed were medium to large manufacturers (sales of approximately $100 million or more) and companies of comparable size in seven other industry groups.

Usable information was collected from 172 companies. The participants were distributed by industry category as follows:

Manufacturing companies	81
Commercial banks	23
Diversified service companies, including computer services, construction/design/engineering, health care, hotel/restaurant/entertainment, real estate, and transportation	19
Utilities, including gas, electric, water and telecommunications	16
Energy and natural resources companies	10
Wholesale and retail trade companies	8
Communications companies, including broadcasting and printing and publishing	6
Health, life, and property and casualty insurance companies	6
Financial service companies	3

The table below shows the the distribution of industry categories according to size. The median, first and third quartiles are determined by total assets for commercial banks; premium income for insurance; operating revenue of utilities; and sales volume for manufacturing, diversified service, energy, communications and trade. There was insufficient data to show size information for financial service companies.

			Middle 50 Percent Range	
Industry	*Number of Companies*	*Median (in millions)*	*Low (in millions)*	*High (in millions)*
Commercial Banking	23	27,000	7,300	51,000
Trade	8	12,000	3,300	20,000
Energy	10	2,708	870	31,600
Diversified Service	19	2,297	2,124	4,818
Insurance	6	2,000	1,191	6,500
Manufacturing	81	1.800	835	6.206
Communications	6	1,780	780	3,400
Utilities	16	1.508	504	2,715

a specified period of continued employment have been a way of delivering company stock to top management at little or no cost to recipients. The expectation is that making employees co-owners of the corporation will focus their attention on long-term growth.

In its evolution over the years, restricted stock has retained this original purpose. However, an increasing minority of companies are now strengthening the link with long-term performance by requiring the achievement of measurable financial goals in order for executives to receive the stock. The report discusses and provides numerous examples of such goals as well as other types of performance criteria being used.

The report also explores other new uses for restricted stock. One is the retention and reward of high potential employees and those with special skills. Another is "exception" grants of restricted stock to those employees, ordinarily not eligible for such awards, who have made an outstanding contribution to the organization.

There are a number of practical concerns involved in structuring restricted stock programs. The survey, which is the basis for this report, gathered data on the major features of programs currently in use. These are analyzed in the report and include: determination of eligibility, frequency of grants, vesting provisions, assistance with income taxes, provisions for dividends, voting restricted shares, and integration of the restricted stock program with other executive compensation plans.

Information is also provided on shares reserved for restricted stock grants in relation to total shares outstanding. The size of the most recent grant to those regularly eligible is analyzed; and a special analysis examines salary levels of the lowest paid eligible employees. Finally, there is an outline of the tax and accounting requirements applicable to restricted stock.

A concluding look into the future indicates that these restricted stock plans will be used in an ever greater variety of ways to help meet strategic corporate objectives.

Introduction

Executive pay typically has three distinct parts: salary, bonus and long-term compensation; peripheral items are perquisites and executive benefits. Salary and bonus are pay for annual individual and corporate performance, respectively. Conversely, long-term pay reflects performance over a period of time greater than one year. The specific types of long-term compensation are stock options, performance unit/share plans, and grants of restricted stock—the subject of this report.

In its simplest form, restricted stock is a grant of the employer's common stock to an executive. The shares granted are subject to restrictions against sale or transfer during a period of continued employment, ranging among the companies surveyed from 1 to 15 years. During the time the restrictions are in force, the recipient usually receives any dividends declared and can vote the stock. When the restrictions lapse at the end of the time period, the recipient gains unconditional, or unrestricted, ownership of the shares.

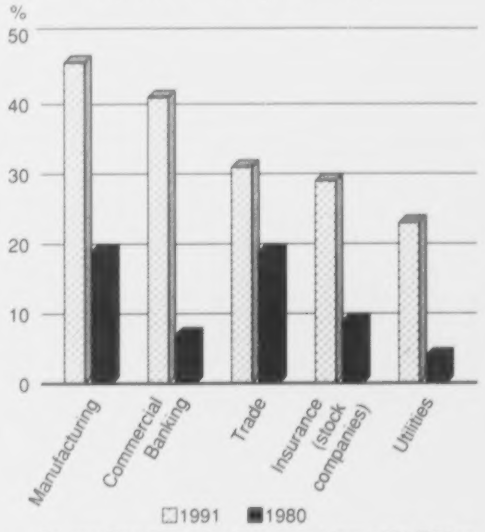
Restricted stock became widely used in the late 1960s, although it had been allowed previously under the Internal Revenue Code, because a unique "loophole" in tax law accorded restricted stock favorable treatment. At the time of grant, there was no taxable event because the restrictions prevented the stock from having a readily ascertainable value. When the restrictions lapsed, the value of the shares *at the time they were originally granted* was taxed as compensation income. Any increase in share value during the restricted period was considered a "free ride" as far as compensation taxes were concerned. If the shares were subsequently sold, taxation was at the then substantially lower capital gains rate on any increase in value between grant and sale.

During this halcyon period, companies rushed to adopt restricted stock plans. Grants were given in the form of "supplemental bonuses" for a select group of top executives. There was also a "golden handcuffs" feature insofar as the executive had to remain employed by the company during the restricted period to eventually receive full ownership of the shares.

The tax-favored treatment of restricted stock came to an end with the passage of the Tax Reform Act of 1969. The taxation of restricted property was changed so the compensation tax was now on the value of the stock *at the time the restrictions lapsed*. There was an escape hatch, however, which allowed an employee to elect immediate taxation. (See "Tax and Accounting Considerations," pages 24-25, for more detail on the present taxation of restricted stock.) Restricted stock languished until the beginning of the 1980s, when an increasing minority of companies in the major industry sectors began adopting plans for granting restricted shares (see Chart 1).

Chart 1:

Prevalence of Restricted Stock Plans by Industry



Source: Top Executive Compensation: 1991 Edition, and 1980 Edition, The Conference Board.

A major factor behind the present appeal of restricted stock is its versatility. In contrast to its rather limited use in the past as a supplemental bonus, restricted stock is now used as:

- motivation and reward for business and/or individual performance by the top executive group;
- a means of linking executive compensation with the long-term performance of the company measured by the market value of the stock;
- a retention device for key employees, including non-executives with special skills;
- "spot" or "recognition" awards for special contributors;
- special awards for high potential employees;
- a sign-on bonus for newly hired executives;
- a supplement or substitute for stock options;
- a form of payout from the annual bonus plan;
- a form of the award under a long-term performance share plan; and
- a way of paying supplemental retirement benefits to executives.

This report will examine the way restricted stock is used by the surveyed companies, including:

- plan objectives;
- eligibility for grants;
- performance considerations;
- size and mechanics of grants;
- period of restriction;
- accelerated vesting;
- practices concerning dividends;
- voting of shares and tax assistance;
- relationship with other plans; and
- how and how many shares are reserved for grants.

Also included is an explanation of the tax and accounting considerations that presently apply to restricted stock.

The report discusses the two ways companies grant actual shares of restricted stock: The first is an outright grant of restricted shares at no cost to the recipient. The second is a grant in the form of an option to purchase restricted shares, usually well below market price.

The two types of outright grants are also discussed. The first is a grant of actual shares of stock that are subject to restrictions. This is classic restricted stock. The other is a grant of "units" that represent shares of stock. These units are subject to restrictions and, at the end of the restricted period, are converted into actual shares, the cash equivalent or a combination of both. Except for instances where a distinction between "shares" and "units" is specified, the term "restricted stock" will also include "units."

Plan Objectives and Eligibility for Grants

Plan Objectives

Restricted stock programs are most often used to retain and reward key executives, high potential employees and individuals with special skills. They also are used to motivate executives to achieve long-term corporate growth, particularly when grants may be forfeited if measurable long-term goals are not met. Finally, restricted stock grants can be used to recognize and reward non-executives for special achievements.

Retention of Employees

Retention of senior executives and high potential employees, reported by 139 companies and 86 companies, respectively, out of the total of 172 respondents, is the most frequently mentioned objective of restricted stock programs. Some comments by survey respondents indicate the importance of this objective. "Restricted stock is used to retain employees vulnerable to offers from other companies," said a petroleum company executive. A paper manufacturing executive reported: "Grants are usually made only when *both* retention and desire to recognize strong performance are present."

Seventeen companies use restricted stock programs to retain and reward personnel with special skills whose continued service is important to the success of the corporation. These employees include scientists, technicians, computer programmers, designers, and traders. Restricted stock grants are intended to secure the employment of select individuals for the duration of the restrictions. For example, a petroleum company grants restricted stock to employees "with unique or needed skills who may also be at or near retirement." At a consumer chemical company, restricted stock is given to "marketing or research people involved in long-term projects." At a retail trade firm, restricted stock may be used to retain "merchandise managers with a good reputation with suppliers."

Achieving Business Performance Goals

Seventy-eight of the 172 respondents use restricted stock grants to link executive performance to the success of the business. In some cases, success is concretely measured by sales, return on investment (ROI), return on equity (ROE), revenue growth, and cash flow. In other cases, the correlation with business performance is much looser. Among this group, three practices are identifiable: The first two make the receipt of restricted stock conditional on goal achievement; the last does not make such a direct correlation.

Past performance determines whether or not restricted stock will be granted and/or the size of the grant. For example, a gas and electric utility executive reported: "Shares are issued when the corporate rate of return exceeds the authorized rate of return for a given year."

Future performance determines the duration of the vesting period and/or the number of shares released from restrictions. For example, a life insurance executive said: "Restrictions will lapse if three-year performance (ROE) goals are attained." (See "Performance Criteria," pages 14-16, for a discussion of those plans tying restricted stock to performance measures.)

Grants are used to identify management's interests with the shareholders and enhance long-term performance, but without using specific goals. By being owners of the company, the interests of the executives are invariably tied to those of the corporation. Both the corporation and the executive will reap the rewards of success or, conversely, suffer the results of failure.

Special Recognition/Special Reward

Twenty-nine companies grant restricted stock as a reward for special achievements by employees who are often not ordinarily eligible for grants. According to an executive of a petroleum company: "Restricted stock is granted for service or effort beyond the call of duty—not an often-cited rationale." "Nominations are made for professional level individual contributors who have made a significant contribution during the fiscal year," said a manager of an industrial chemical manufacturing company. For those individuals, not usually eligible for restricted stock, these awards are very prestigious and clearly illustrate the value placed on their contributions.

Other specific practices worth noting include granting restricted stock when someone is promoted (three companies do this), and granting shares of restricted stock as an alternative to cash awards (two companies follow this practice).

Other Objectives

Fifteen companies reported other objectives for restricted stock programs. These fall into two categories: to recruit senior executives and high potential employees, and as part of or an alternative to their executive benefits program.

Twelve companies in this study use restricted stock to recruit senior executives and high potential employees. For example, a financial service firm grants restricted stock to newly hired senior level executives as an "upfront share ownership" award. An industrial machinery manufacturing company uses it as a sign-on bonus for new executives and sometimes as a supplemental retirement benefit to induce executives hired late in their careers to accept employment.

Three companies use restricted stock either as part of, or an alternative to, their executive benefits programs. A precision instrument manufacturing company uses restricted stock to fund their SERP (Supplemental Executive Retirement Plan), and a food manufacturing company grants restricted stock to "provide pension benefits on executive bonuses." At a rubber manufacturing company, restricted stock is designated in executive employment agreements as a substitute for a pension.

Groups Eligible

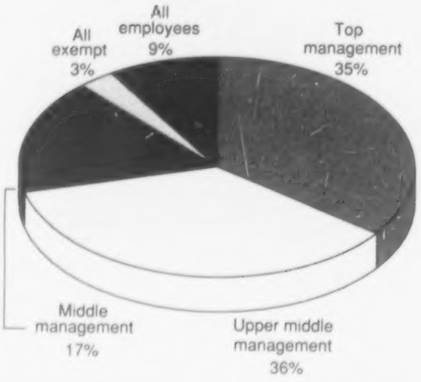
To get a true picture of who is actually eligible for grants of restricted stock, it is necessary to go beneath the language of the plan, which is usually some variation on "officers and other key employees."

A total of 152 companies out of the 172 respondents provided details on eligibility. One hundred thirty-three of these amplified their eligibility clauses by saying that top executives were eligible for grants, and that eligibility could extend down into the organization. This gives them the latitude in actual practice to select whatever groups or individuals are to receive grants according to specific strategic needs.

The practices of these 133 companies is shown in Chart 2. The majority limits grants to top and upper middle management; 95 (71 percent) did not go below the upper middle management level. Grants made below this level become progressively more selective the further down they reach.

Chart 2:

Eligibility Practices



Lowest group eligible	Number of Plans
Top management	47
Upper middle management	48
Middle management	22
All exempt	4
All employees	12
Total	**133**

The remaining 19 plans do not fit the above pattern. Their eligibility practices fall into three groups:

(1) Eight plans have two distinct eligible groups. Regular grants are made to senior executives and, on a highly selective basis, to certain employees with high potential and/or special skills. For these employees, restricted stock has a threefold impact: as a symbol of

Table 1: Salary of Lowest-Paid Restricted Stock Recipients

Salary	*Plans* *Number*	*Percent*
$500,000 and over	1	1%
300,000-499,000	3	2
200,000-299,000	9	6
150,000-199,000	10	7
100,000-149,000	44	30
75,000-99,000	30	20
50,000-74,000	32	22
25,000-49,000	15	10
Less than 25,000	3	2
Total	147	100%

Median	*Middle 50 Percent Range* *Low*	*High*
$89,000	$60,000	$131,000

their importance to the organization, as additional compensation, and as a retention device.

(2) Another eight companies depart from the prevailing practice and make grants *only* to employees below the top management level, usually upper middle management and middle management. In most cases, stock options are used for the top management group.

(3) A final group of three companies makes awards on a very limited basis to certain newly hired executives and selected key employees whose retention is crucial.

Lowest-Paid Eligibles

The salaries of the lowest-paid restricted stock recipients in 147 plans are shown in Table 1. These are employees who are eligible for regular grants, mostly top and upper middle management executives. Employees receiving special grants are not included. As indicated in the table, the lowest salary level in the largest number of plans (44) is in the $100,000 to $150,000 range.

Performance Criteria

Executive compensation has become more reliant on performance measures as determinants of pay, whether that pay be salary increases, annual bonuses or long-term rewards.

In keeping with this trend, restricted stock grants are increasingly tied to performance measures. Performance considerations can be implemented in two ways. First, individual performance can be a requirement for a grant of restricted stock. In other words, the grant is a reward for an employee's *past* performance. Second, the release of shares from restrictions can be conditional on the achievement of certain goals during the restricted period. In other words, lapse of restrictions is conditional on *future* performance.

Ninety-six (56 percent) of the 172 plans studied have requirements relating to past performance, future performance, or both. Based on anecdotal knowledge of past practices, this indicates a substantially increased use of performance measures. The criteria for evaluating past and future performance are discussed in separate sections that follow. Fourteen of these plans evaluate both past and future performance. In virtually all these cases, the evaluation of past performance is discretionary, while future performance is measured by the achievement of very specific financial goals.

Past Performance

Sixty-two companies take individual past performance into account when deciding whether to grant an employee restricted stock and/or how large the grant should be. These are companies that use restricted stock as a regular part of their compensation programs. Obviously, those companies using restricted stock for special purposes such as recognition and spot awards base the grant exclusively on individual past performance and constitute a different category from those considered here.

Fourteen of the 62 plans have specific mechanisms for evaluating individual past performance for receipt of grants and/or grant size. (This doesn't mean that the determination is not subjective; just that a formal appraisal system is used rather than a completely discretionary evaluation.) In these cases, the whole performance of the individual is rated by an appraisal process similar to performance appraisal for the purpose of determining a merit increase. A utility, for example, has a rating scale with five performance levels, which is used to determine part of the grant (the other part is according to salary grade). A manufacturer determines the size of the grant by a "value rank" consisting of job size, actual performance and potential.

Some of the 14 evaluate performance according to the accomplishment of specific objectives, often financial. This is most like the sort of evaluation done in connection with annual bonus awards. For instance, one manufacturer measures the performance of the eligible key executives in terms of increased profitability and stock market value. A service company bases the grant on the contribution of key employees to profitability.

Forty-six of the 62 plans make discretionary grants. At whose discretion is a function of the organizational level of the recipient. For example, in one company determination of grants to the CEO is made by the compensation committee of the board of directors; while in the case of senior executives, there is an evaluation and recommendation by the CEO with review and approval by the board. By contrast, under another company's plan that covers just lower management, many of whom are in business units, the initial recommendation is made by the local manager and then reviewed by division upper management and finally approved by corporate management.

These 46 discretionary plans do not have a formal mechanism for evaluating performance for a restricted stock grant. But this doesn't mean the individual's performance is not evaluated; just that it is done without specific guidelines or written criteria. For example, an engineering/construction company compensation executive said: "Eligibility is determined by grade level, but the grant and its size is discretionary based on performance under general guidelines." A service company executive said: "The Chairman has discretion to increase or decrease indicated grants based on an individual's performance." And finally, an executive from a retail trade firm said: "Status and responsibility are primary considerations, but grants are adjusted for recent performance and seniority."

Many of the companies reward past performance, but they also take into account expected future performance or potential. Used this way, restricted stock both compensates high potential employees and ensures their retention by "handcuffing" them to the corporation with the requirement that they must remain employed in order to receive full ownership of the stock. In a fairly typical statement, a manager in a food manufacturing company said that past performance of the eligible group (executives earning $100,000 and up) was taken into account but "even more important, the grant relates to the potential future contributions we believe the individual will make."

The remaining two companies in this group use restricted stock as a form of payout from their incentive plans, so the restricted stock grant relates to whatever past performance criteria are used for the incentive award. One company, a utility, pays annual bonuses greater than $10,000 in restricted stock; the other, a service company, pays out its "individual performance award" in restricted stock if the recipient so elects.

Future Performance

In addition to the standard requirement of continued employment as a condition for receiving unrestricted ownership of shares, 34 of the 96 plans with performance criteria also require the achievement of certain goals, generally long-term financial targets. Depending on the plan, achievement of the goals has one of two results. In most cases (29 plans) goal achievement is necessary for receipt of all or part of the grant at the end of the restricted period. In the remaining five plans, all or part of the grant can be released from restrictions earlier than specified when and if the goals are achieved. The two practices can be contrasted as: goal achievement determining the *number* of shares eventually received vs. goal achievement determining the *duration* of the restricted period.

When long-term financial goals are introduced, these restricted stock plans become a subset of executive compensation plans called "long-term performance unit/share plans." These plans originated in the early 1970s, a time of high corporate earnings but poor stock market performance. They were intended as an alternative to stock options, the latter being of no value if stock price declines or remains static.

Under performance unit/share plans, a contingent award of units (cash) or shares (stock) is made to an executive. The eventual receipt of the award is conditional on the achievement of three- to five-year financial goals. In the generic plan, if the contingent award is in shares a ledger account is simply credited with a numeric representation of the number of shares. This amount is converted into actual shares at the time of payment. When restricted stock is used, the contingent award consists of actual, but restricted, shares. When and if the goal is reached, the restrictions lapse. Some compensation practitioners believe using actual shares provides extra motivation to achieve the goals, especially if the participant is reminded of the shares during the restricted period by voting the stock and receiving dividends.

Within this general framework, there is a great deal of variation among companies in the specific goals used and the plan mechanics. Generally, whatever the goals, very specific measures of achievement are used, and their achievement triggers the reward. Unlike past performance plans, there is usually no latitude for subjective evaluation of individual performance. The goal is numeric and its achievement is measured numerically. Following are examples of different practices which show the diversity encountered.

- A *utility company* sets a three-year goal of an increase in return on equity relative to the average of a peer group. If this is achieved, the restrictions lapse. This is the type of goal and performance period used in a majority of "straight" long-term unit/share plans.
- Another *utility* requires the company's total return to shareholders to reach at least the 50th percentile of the average return of a competitive group in order for shares to be released from restrictions. If the company's performance is below the 50th percentile, the shares are forfeited.
- An *energy company* uses a three stage target. Restrictions lapse on the entire grant if stock price appreciates 8 percent over three years. If the stock price appreciates 6 percent, restrictions lapse on 50 percent of the grant. If appreciation is less than 6 percent, the grant is forfeited.
- A *food products manufacturer* requires its stock to trade at a designated threshold price for 10 consecutive days prior to the scheduled lapse of restrictions.
- A *high technology company* uses the less common approach of accelerated vesting if the targets are met. The ordinary vesting schedule is nine years; three year financial goals are set. As (and if) each goal is met, one-third of the grant is released from restrictions.
- A *primary metals company* uses accelerated vesting in a five year plan. One-fifth of the grant can vest each year if an annual performance target is met. A unique twist on the usual practice con-

sists of granting an additional number of restricted shares each time restrictions lapse. This brings the number of shares under restrictions back up to the prior level. This is an interesting way of increasing the motivation and reward effect of meeting goals.

- An equally interesting variation is used by a *paper manufacturing company*. The grant vests in equal installments over eight years. If return on equity exceeds a designated percent in any year, there is an additional grant equal to part of that year's vested shares. These additional shares vest in one year.

The financial goals described above are used by a minority of the plans studied. However, anecdotal indications are that they are, and will be, increasingly utilized—since one of the criticisms of restricted stock has been the lack of performance requirements in cases where the release of shares from restrictions depends solely on continued employment. ("The only requirements are that the recipient show up and keep breathing," said a critic.) The addition of performance requirements makes these plans true long-term incentive arrangements and should help assuage concern about excessive executive compensation unrelated to company performance.

Restricted Stock Grants

Size of Grants

While many factors relating to individual and company performance may influence the size of grants, base salary, which identifies the employee's level in the company hierarchy, usually serves as a guide for determining the relative size of grants. Therefore, companies were asked to report the base salary and the value of the most recent grant to the CEO and the average and lowest-paid recipients. The latter are those eligible for regular grants and do not include employees receiving "exception" grants. The value of the grant is the number of shares or units awarded multiplied by the market value of the shares on date of grant.

As shown in Table 2, the median CEO grant is about two-thirds of base salary. The median grants for average and lowest-paid fall off substantially—to 29 percent and 21 percent of base salary, respectively.

Mechanics of Grants

Several considerations concerning restricted stock grants must be resolved when a plan is installed or modified. These include the frequency of grants, whether the grant is at no cost to the recipient or in the form of an option, whether the grant is in actual shares or units and, if the latter, how payment is made when the restrictions lapse.

Frequency of Grants

Survey participants were asked about the frequency with which grants were made (not necessarily to the

Table 2: Size of Restricted Stock Grants

			Number of Plans			
	CEO		*Average-Paid Recipients*		*Lowest-Paid Recipients*	
Size of Grant as Percent of Salary	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
300% and over	10	9%	2	2%	2	2%
250-299	3	3	1	1	1	1
200-249	6	5	1	1	–	–
150-199	7	6	2	2	5	4
100-149	16	14	14	11	2	2
75-99	13	11	9	7	9	7
50-74	22	19	12	9	12	9
25-49	21	18	35	27	27	21
20-24	6	5	9	7	13	10
10-19	10	9	32	25	31	24
Less than 10%	3	3	11	9	29	22
Total Plans	117	100%	128	100%	131	100%
Median Grant as Percent of Salary	67%		29%		21%	
Middle 50% Range	34-134%		16-66%		10-45%	
Median Value of Grant	$352,000		$40,000		$20,000	
Middle 50% Range	$164,000-811,000		$18,000-100,000		$7,000-52,000	
Median Salary	$550,000		$150,000		$82,000	
Middle 50% Range	$425,000-710,000		$95,000-188,000		$61,000-127,000	

same individual). Significant practice falls into two categories. The majority (63 percent of the 155 responses to this question) make grants every year. The other group (20 percent) has no set interval between grants. These companies make them as needed to accomplish the objectives of their plans. The remaining 17 percent have practices ranging from several times a year to once every five years.

The two major practices represent two distinct approaches to restricted stock. Those making annual grants use restricted stock as an integral part of their executive compensation programs. In most cases, eligibility is limited to top and upper middle management executives. This group receives regular grants, although the same person doesn't necessarily receive a grant annually.

By contrast, the group making "ad hoc" grants often uses restricted stock for very specific purposes ancillary to the regular compensation program and frequently, more lower-level people are eligible than is the case with the first group. For instance, they may use restricted stock to recognize and reward special accomplishments. This is the so-called instant incentive, spot award, or "lightning strikes" device where a special achievement is immediately rewarded and recognized by, in this case, a restricted stock grant. Some use restricted stock to retain valued employees, for example, those with special skills. Restricted stock can also be used by these companies as a "sign on" bonus when recruiting senior executives or those with special skills. (See "Plan Objectives and Eligibility for Grants," pages 11-13, for a discussion of how grants are used to accomplish various purposes.)

Outright Grants vs. Options

Of the 172 companies surveyed, 155 (90 percent) grant restricted shares or units at no cost to the recipient. Thirteen companies (8 percent) grant options to purchase restricted shares. Four companies may either grant shares or units outright or grant options to purchase restricted shares.

When an option is granted, the option price may either be a fixed dollar amount *or* a percent of fair market value (FMV) at the time of grant. Nine of the 17 companies that grant restricted stock options set fixed dollar amounts that range from 10 cents to $5 per share. The most frequent amount (five companies) is a dollar a share.

Five companies set the option price at a percent of FMV at the time of grant. A furniture manufacturing company has the lowest option price, 25 percent of FMV; while the highest is an electrical/electronic manufacturer at 100 percent. A food manufacturer sets the price at 50 percent of the average of the high and low market value, while an industrial chemical manufacturing company has an option price of 78 percent. The fifth company did not state its option price.

The remaining three companies use different formulas to determine option price. For example, a transportation company determines the price by the "year end book value" of its shares.

Shares vs. Units

Restricted stock may be granted as *actual shares* of company stock or as restricted *units.* One hundred fifty-three (90 percent) of the 172 companies surveyed award actual shares of restricted stock; 12 companies (7 percent) award restricted units only, and seven companies (4 percent) award both actual shares and units.

Payment From Unit Plans

Among the 19 companies granting restricted units, payment when the restrictions lapse can be in stock, cash or a combination of both. Ten companies pay in cash while six pay in stock. One of these, a transportation equipment manufacturer, ordinarily pays in stock, but may pay in cash at the Compensation Committee's option. Only one, a paper manufacturing company, uses a combination of stock and cash. In the remaining two companies, the Compensation Committee determines whether payment will be in cash, stock or a combination.

Basic Plan Provisions and Administration

Lapse of Restrictions

Restrictions can lapse on all shares at once (cliff vesting) or may lift in installments (installment vesting). The two practices are discussed following.

Cliff Vesting

The restricted period is a specific number of years following the date of grant. In *cliff vesting*, all restrictions lift at the end of this period, and the recipient gains unconditional ownership of the entire grant. The majority (85 percent of the 78 respondents with cliff vesting) have restricted periods ranging from three to five years. Table 3 shows the durations of the restricted periods.

A special vesting schedule was reported by one company. A fabricated metal manufacturing company executive said: "While the restricted period is usually four years, it is five years for mega-grants." (Megagrants are millon-dollar grants to CEOs.)

Installment Vesting

The alternative to cliff vesting is when the grant vests in installments over the whole restricted period. (Plans that accelerate vesting if performance targets are met are not analyzed here. See "Performance Criteria," pages 14-16, for a discussion of these arrangements.)

In 78 plans, grants vest in installments over the duration of the restrictions, after an initial waiting period. The waiting period is usually a year, but in a minority of cases is longer. Equal annual installments are typical, but some may be less frequent. A few vest in unequal installments. The variations can be grouped into four categories, described below in order of prevalence.

(1) In 40 plans, grants vest in equal annual installments beginning one year after grant. The vesting periods range from two to ten years, with five years the most common.

(2) Sixteen other plans also specify vesting in equal installments. However, there is a "waiting period" greater than one year after grant before vesting begins, and the installments may vest less frequently than annually. The waiting periods reported were two, three and five years. After the waiting period, the number of installments range from two to ten. Under three plans grants vest in two installments in the third and fifth year. One plan vests 50 percent of the grant after five years and the remainder at retirement. All the others vest grants in equal annual installments.

(3) Ten plans vest grants in unequal annual installments after waiting periods greater than one year. Eight begin vesting three years after grant, and two start vesting five years out. The asymmetrical vesting schedule can be skewed either toward the beginning or the end of the restricted period. For example, one plan vests 20 percent after three years, 30 percent after four years, and 50 percent after five years. Another vests 50 percent after three years and 25 percent in the fourth and fifth years.

(4) In five cases, grants vest in unequal annual installments beginning one year after grant. The practice in four cases is to vest larger amounts in the later years of the vesting period. For example, one plan vests 20 percent after the first year, 30 percent after the second, and 50 percent after the third. The most highly skewed

Table 3: Duration of Restricted Period

Years in Restricted Period	Plans Number	Plans Percent
1	1	1%
2	2	3
3	24	31
4	14	18
5	28	36
6	1	1
7	2	3
8	–	–
9	–	–
10	5	6
15	1	1
Total	78	100%

of these four is one vesting 10 percent a year for five years and the remaining 50 percent after six years. The remaining case in this group vests 50 percent after the first year and 25 percent a year for the next two years.

Five plans stated that installment vesting schedules could be different for different grants. The remaining two of the 78 plans have atypical vesting schedules. In one plan, vesting does not begin until retirement and then proceeds at the rate of 20 percent a year. The other plan uses restricted stock units as the form of the annual bonus award. The grant is made in December, one-third is paid out the following January, and then one-third is paid out each year for the next two years.

Accelerated Vesting

Accelerated vesting of restricted stock prior to the end of the restricted period may be triggered by death, permanent and total disability, retirement or change of control. (Accelerated vesting when performance goals are met is covered in the section, "Performance Criteria.") The actual mechanics of accelerated vesting vary considerably.

Death

In 122 plans (71 percent), vesting of restricted shares accelerates if the recipient dies. Often other conditions must also be met for accelerated vesting. For example, an industrial chemical manufacturing company, where grants vest in installments, reports that accelerated vesting in the event of death occurs only if the first installment has been released from restrictions. A few plans leave accelerated vesting arrangements on death to the discretion of the Compensation Committee. For instance, a commercial bank executive said: "At the time of death, 20 percent vests per year unless accelerated by the Committee."

Change of Control

In 117 plans (68 percent), vesting may accelerate in the event of a change in control of the company. This change in control may be due to a merger, acquisition, or bankruptcy. For example, vesting could be accelerated to persuade an executive to remain with an acquired company during the transition period.

Permanent and Total Disability

One hundred and five plans have provisions for accelerated vesting if an executive is permanently and totally disabled. Specific practices vary from company to company. For example, in a paper manufacturing company, 50 percent of the shares vest immediately if the recipient is disabled. In a retail trade organization and a transportation company, both having installment vesting schedules, shares vest in accelerated installments if the executive is disabled.

Retirement

In 88 plans, retirement accelerates vesting. The definition of retirement differs from company to company. For example, a transportation company vests grants on retirement at age 60, while a retail trade organization and a paper manufacturing company accelerate vesting on retirement at 62. Five plans vest fully only if retirement occurs at age 65; while three plans specify "normal" retirement and exclude early retirement. Four of the 88 plans leave vesting at retirement to the discretion of the Compensation Committee.

Other Conditions

In seven plans, the Compensation Committee can accelerate vesting in special situations. One such situation is described by a petroleum company manager who said: "The Compensation Committee may waive restrictions on the basis of performance or service." A manager at another energy company reported: "In special situations such as retirement prior to age 65, grants can vest immediately with special board approval."

Eight plans accelerate vesting when employment terminates under certain unusual circumstances. A transportation equipment manufacturing executive said: "Restricted stock awards will vest fully when employees terminate with the consent of the corporation to enter government service." Two other companies reported that grants vest immediately on termination of employment at the request of the company but not for cause. In a diversified service company, grants vest fully on termination due to a layoff; while a transportation company makes immediate vesting part of severance agreements.

Relationship With Other Plans

Forty-seven respondents said grants of restricted stock affected awards under other executive compensation plans, including stock options, stock appreciation rights, performance unit/share plans, or annual cash bonus plans. The practices of the 41 companies that provided details on this relationship fall into four categories.

(1) Three plans (two in banking, one utility) make a subjective determination on a case-by-case basis of the relationship among awards but do not have specific guidelines or standards.

(2) In 14 companies a restricted stock grant precludes a grant under any other plan that year, in most cases, this means no stock option grant.

(3) Fourteen plans make the size of restricted stock grants a function of the size of grants under another plan, usually the stock option plan. For example, a furniture manufacturer gives a restricted stock grant equal to

50 percent of the stock option grant; an aerospace company reduces the stock option/stock appreciation right grant by two shares for every one restricted share granted; and a bank grants one restricted share for every three option shares granted.

(4) The last group of ten plans determines a target long-term grant value (either for each participant, all participants as a group, or groups of participants). Once the total value is determined, a further determination decides what portion of the long-term grant will be represented by each vehicle. A typical statement is by a banking executive, who said: "Annual recommendations are stated in terms of a total number of shares. The percent granted as options or as restricted stock is determined by the CEO and the board." A personal products manufacturer is the exception in this group, reporting that restricted stock is always 25 percent of the total value of the long-term grant.

Assistance With Income Taxes

There is compensation income tax liability when restrictions on a grant of stock lapse or, at the recipient's election, when restricted stock is initially granted (see "Tax and Accounting Considerations," pages 24-25, for details on this election). The survey participants were asked if their plans or practices made any provision for assisting restricted stock recipients with income taxes due. Thirty plans had such provisions. With the exception of one that gave no detail, the practices of the others can be grouped in the following categories.

Gross-up

Nine plans "gross-up" so the participants can meet their tax liability. Grossing-up entails the company paying the income tax due on the stock.

> ***For example:*** Restrictions lapse on executive Deleuze's 100 shares of Nova Lexicon Company stock with a market value of $10 per share. The value of the stock for taxation is, therefore, $1,000. She is in a 31 percent tax bracket, so compensation income tax due is $310 (ignoring for simplicity's sake all other income and deductions). The company "grosses her up" by giving her the $310 she needs to pay the tax. Of course, this is additional taxable compensation to her of $310 so, theoretically, a gross-up could continue in ever decreasing amounts until like the mythical bird it disappears.

Four of the nine companies grossing-up (two manufacturers, one service company, one trade firm) will do this only if the participant elects to be taxed at the time of grant rather than when the restrictions lapse.

Several survey participants commented that they did not gross-up every time for every recipient. For example, a manufacturer did this only for the employee selected as "researcher of the year." A retail trade company grosses-up only for selected "non-executive" recipients. This selective practice indicates some sensitivity surrounding executive compensation in general and restricted stock in particular. When a grant is cost-free and unencumbered by performance considerations, shareholders and the media could look askance at the company helping executives pay their taxes.

Cash Bonus

It is the practice of seven companies to pay a cash bonus to help recipients with taxes due on restricted stock. One manufacturing company simply pays a cash bonus equal to the value of the shares, which would cover the taxes due and then some. In all other cases, there is a corporate performance requirement that must be met to trigger the cash bonus. The performance requirements are usually long-term financial goals such as improved return on assets or return on equity.

Stock-for-Tax Withholding

Eight plans provide "stock-for-tax withholding." In these cases, when restrictions lapse shares are "withheld" by the company in a number sufficient to pay the income taxes due on the total distribution. Referring to the example used to illustrate gross-up, in the same circumstances, 31 shares with a value of $10 a share are withheld to pay the $310 due in taxes. This methodology reflects a current concern of corporations––that is, encouraging executives to hold employer stock to strengthen the link between executive and shareholder. Some believe that if recipients must sell stock to pay taxes, there is a tendency for them to sell more shares than required. If withholding is done before the shares are delivered, there is no necessity to sell any.

A sub-set not included above is the practice of three companies (a transportation equipment manufacturer, a diversified service company, and a commercial bank) that make grants of restricted units rather than actual shares. In these cases, a sufficient number of units are withheld to pay the taxes, and the rest are converted and distributed as actual shares.

Loans

Two commercial banks have provisions for lending recipients money to pay taxes on restricted stock. One describes the practice as: "A loan at the prevailing applicable federal rate, repaid by payroll deduction over 20 biweekly pay periods."

Dividends and Dividend Equivalents

Dividends

One hundred forty-nine of the 172 respondents pay dividends on restricted stock. One hundred twenty-eight pay dividends during the restricted period. Ten companies defer payment of dividends until the restrictions lapse, on the grounds that the recipient should not share in the success of the corporation until conditions of the restricted awards are satisfied. Five companies allow recipients to choose current payment (payment during the restricted period) or deferral.

Four companies reported other dividend payment arrangements. Two utilities use the dividends to buy additional shares. A high-tech communications company has different plans which may specify either current or deferred dividend payment. A transportation equipment manufacturing company determines current or deferred payment for each grant.

Two companies did not provide information on their dividend payment practices.

Dividend Equivalents

Eighteen companies pay dividend equivalents (an amount equal to declared dividends times the number of units granted) on restricted units. Eleven pay dividend equivalents currently; while four companies defer payment until the units vest. An aerospace manufacturing company allows recipients to choose either current payment or deferral, and the transportation equipment manufacturing company mentioned above which determined current or deferred dividend payment for each grant of restricted shares, has the same practice with respect to units. One company did not provide information on its payment practice.

Voting

One hundred forty-four of the 172 respondents allow recipients to vote the stock during the restricted period. These companies believe that although the recipients do not have full ownership of the stock until the awards are fully vested, they should be allowed to participate in the decision-making process and exercise their voting rights as owners and partners of the corporation. Conversely, the minority of companies that do not give voting rights believe the privileges of ownership should not occur until the shares are fully earned.

Shares Reserved

Shares used for restricted stock grants may either be specifically reserved for such awards or may be part of a pool of shares reserved for different types of stock grants, including stock options and/or performance shares.

Fifty-five plans reserve shares specifically for restricted stock grants. Table 4 shows the shares reserved as a percent of total outstanding in the 34 companies that provided information.

In 95 companies, one pool of shares is reserved for all types of stock grants. Table 5 shows the amount reserved in the 74 reporting this information.

Sixteen of the 95 companies limit the number of shares from the total pool that can be used for restricted stock grants. This limitation may be as little as 0.5 percent of the reserve to as much as 50 percent (see Table 6).

Table 4: Shares Reserved for Restricted Stock Grants as Percent of Total Shares Outstanding

	Plans	
Reserved Shares	*Number*	*Percent*
10% and over	1	3%
9.0-9.9	–	–
8.0-8.9	1	3
7.0-7.9	1	3
6.0-6.9	1	3
5.0-5.9	2	6
4.0-4.9	2	6
3.0-3.9	4	12
2.0-2.9	5	15
1.0-1.9	7	21
Less than 1.0%	10	29
Total	34	100%

	Middle 50 Percent Range	
Median	*Low*	*High*
2.3%	1.0%	4.5%

Table 5: Shares Reserved for All Stock Grants as Percent of the Total Outstanding

	Plans	
Reserved Shares	*Number*	*Percent*
15% and over	1	1%
10.0-14.9	7	10
9.0-9.9	2	3
8.0-8.9	1	1
7.0-7.9	5	7
6.0-6.9	5	7
5.0-5.9	16	22
4.0-4.9	8	11
3.0-3.9	9	12
2.0-2.9	10	14
1.0-1.9	4	5
Less than 1.0%	6	8
Total	74	100%

	Middle 50 Percent Range	
Median	*Low*	*High*
4.7%	2.5%	6.0%

Table 6: Shares Limited for Restricted Stock Grants as Percent of Total Reserved for All Stock Grants

	Plans	
Shares Limited	*Number*	*Percent*
50% and over	2	13%
40-49	2	13
30-39	2	13
20-29	1	6
10-19	4	25
Less than 10%	5	31
Total	16	100%

	Middle 50 Percent Range	
Median	*Low*	*High*
10.0%	2.0%	33.0%

Tax and Accounting Considerations

There are a number of tax and accounting considerations involved in the use of restricted stock and restricted units. Following is a summary of the major requirements. It must be emphasized that this is a general overview, and it is not intended and should not be construed as a definitive interpretation of tax and accounting requirements. Such interpretation can only be given by qualified legal and accounting practitioners.

Taxation of Restricted Stock

Restricted stock, either as an outright grant or an option, usually is designed to postpone employees' tax liability, if they so desire, until the restrictions lapse. To achieve this, the plan or agreement must contain two provisions. First, the stock must carry a *substantial risk of forfeiture*. Generally, this substantial risk is the requirement that the employee complete a stated period of continued employment before the restrictions lapse. Second, the stock *cannot be transferred* free of restrictions. If these requirements are met, the employee is not taxed when the stock is granted and will not be taxed until the restrictions lapse. At that time, the employee is taxed on the present value of the stock as compensation income (minus the purchase price if an option).

An exception to the above occurs if the employee elects under Section 83(b) of the Internal Revenue Code to be taxed at the time of the grant. In this case, the employee pays compensation income tax on the value of the stock at grant, without regard to the restrictions. The advantage is that if the stock increases in value during the restricted period, there is no additional tax when the restrictions lapse. However, there is both an economic and a tax risk to this election. The economic risk is that the stock may decrease in value during the restricted period. The tax risk is that if the stock is forfeited, there is no refund, tax credit or deduction allowed for the tax already paid. Consequently, this election is very rarely made. (See "Assistance With Income Taxes," page 21, for situations where a company will assist an employee with taxes providing an 83(b) election is made.)

Any dividends paid to the employee during the restricted period are taxed as compensation income. If the 83(b) election is made or if the dividends are deferred until the restrictions lapse, they are taxed as dividend income rather than compensation.

The company granting restricted stock is entitled to a compensation expense deduction at the same time and in the same amount as the employee's compensation income tax liability. In those situations where dividends are treated as employee compensation, they are deductible by the company as a compensation expense. If they are taxed as dividends, however, they are not deductible.

Accounting Treatment of Restricted Stock

Generally, the compensation expense that must be accounted for is the market value of the stock at grant (minus purchase price if an option). This amount is usually charged to earnings pro rata over the restricted period.

Earnings per share are diluted when restricted stock is granted, since this involves the issuance of actual shares usually with dividends and voting rights.

Taxation of Restricted Units

Since no actual shares are granted, there is no taxation until the restrictions lapse and the units are converted into actual shares, cash or a combination. The employee is taxed on this amount as compensation income, and the company receives a deduction at the same time and in the same amount. Any dividend equivalents are taxed as compensation when paid and are deductible by the company at the time of payment (see box, p. 25).

Accounting Treatment of Restricted Units

The accounting treatment is the same as for restricted shares, except for those units to be paid in cash. Changes in share value during the restricted period are recorded as a compensation expense for these units. Units to be paid as actual shares are treated as the equivalent of company stock during the restricted period for the purpose of earnings per share calculations.

TAX CONSIDERATIONS

	SITUATION	EMPLOYEE	COMPANY
Restricted Stock	Restrictions lapse	Taxed as compensation	Deducted as compensation expense
	Employee elects to be taxed at the time of the grant – Section 83(b)	Taxed as compensation	Deducted as compensation expense at the time of election
	Dividends paid during restricted period	Taxed as compensation when paid	Deducted as compensation expense at the time of payment
	Dividends deferred until restrictions lapse	Taxed as dividend income when paid	Not deductible
Restricted Units	Restrictions lapse and units are converted into actual shares, cash, or a combination	Taxed as compensation	Deducted as compensation expense
	Dividend equivalents	Taxed as compensation	Deducted as compensation expense

Conclusion

When first widely used, the primary purpose of granting restricted stock was to retain senior executives and to provide them with additional compensation. Now, restricted stock is increasingly being used to help achieve a variety of objectives.

One of the most important of these objectives is long-term corporate growth. Concrete measures of long-term performance are being introduced into restricted stock plans. Particularly noteworthy are those plans where the lapse of restrictions depends on achieving specific long-term financial goals. Although in the minority, indications are that these will increase as more companies use compensation as a strategic device to foster the long-term success of the organization.

There has been increased emphasis on the importance of stock ownership by executives. This has long been regarded as a way of welding management and shareholder interest, and, of late, it is getting more attention. Restricted stock is a way of providing executives with equity. When coupled with the trend toward performance measures, restricted stock plans get shares into the hands of executives and, because of performance requirements, escape the charge that they are simply a stock giveaway program.

The recent move toward decentralization and the increased autonomy of the business unit brings into prominence business unit executives, who are usually at the middle management level. With their greater scope of action in managing business units, they become candidates for executive compensation programs previously limited to top corporate executives. Therefore, along with annual bonuses, stock options and the like, restricted stock is now being used to motivate and reward these managers.

Companies are increasingly aware of the need to recruit and retain employees with special skills and those with high potential. Grants of restricted stock are now used to recruit and reward these employees. The continued employment provision in restricted stock grants binds them to the organization with "golden handcuffs."

The concern with cost control and the need to raise employee quality of work and productivity has caused companies to turn to variable pay, non-traditional programs for non-management employees. These programs, including profit sharing, gainsharing and small group incentives, cover employees formerly excluded from incentive compensation. In this context, restricted stock is used to reward and recognize these employees for outstanding achievements. As the link between compensation and employee quality/productivity is tightened, restricted stock will probably continue to play a small but important role in the compensation of non-managerial personnel.

Thus, restricted stock has evolved from its original application to a small group of top executives to its present diverse uses. As compensation programs become ever more flexible to meet changing business needs, all indications are that this diversity will increase.

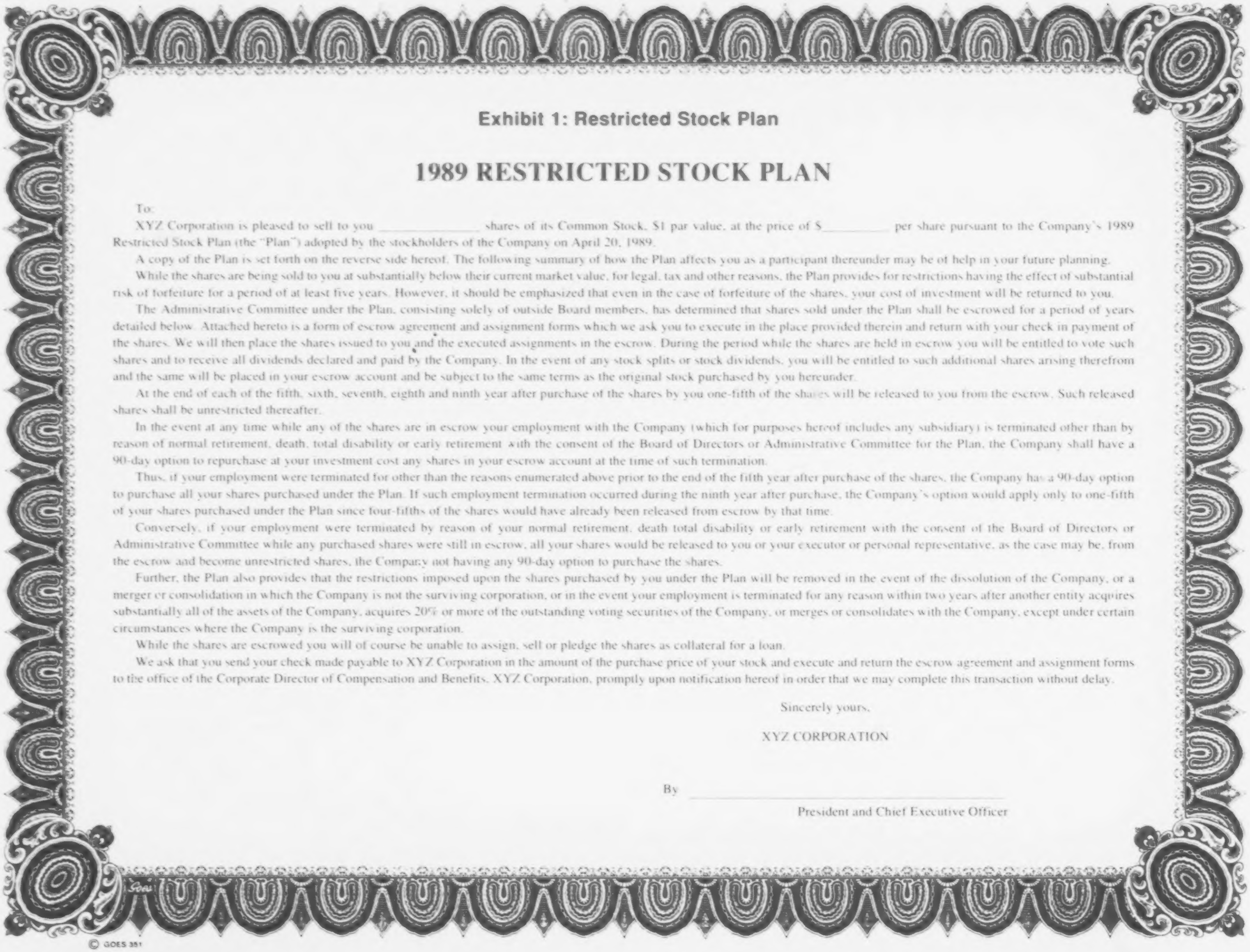


Exhibit 1: Restricted Stock Plan

1989 RESTRICTED STOCK PLAN

To:

XYZ Corporation is pleased to sell to you _______________ shares of its Common Stock, $1 par value, at the price of $__________ per share pursuant to the Company's 1989 Restricted Stock Plan (the "Plan") adopted by the stockholders of the Company on April 20, 1989.

A copy of the Plan is set forth on the reverse side hereof. The following summary of how the Plan affects you as a participant thereunder may be of help in your future planning.

While the shares are being sold to you at substantially below their current market value, for legal, tax and other reasons, the Plan provides for restrictions having the effect of substantial risk of forfeiture for a period of at least five years. However, it should be emphasized that even in the case of forfeiture of the shares, your cost of investment will be returned to you.

The Administrative Committee under the Plan, consisting solely of outside Board members, has determined that shares sold under the Plan shall be escrowed for a period of years detailed below. Attached hereto is a form of escrow agreement and assignment forms which we ask you to execute in the place provided therein and return with your check in payment of the shares. We will then place the shares issued to you and the executed assignments in the escrow. During the period while the shares are held in escrow you will be entitled to vote such shares and to receive all dividends declared and paid by the Company. In the event of any stock splits or stock dividends, you will be entitled to such additional shares arising therefrom and the same will be placed in your escrow account and be subject to the same terms as the original stock purchased by you hereunder.

At the end of each of the fifth, sixth, seventh, eighth and ninth year after purchase of the shares by you one-fifth of the shares will be released to you from the escrow. Such released shares shall be unrestricted thereafter.

In the event at any time while any of the shares are in escrow your employment with the Company (which for purposes hereof includes any subsidiary) is terminated other than by reason of normal retirement, death, total disability or early retirement with the consent of the Board of Directors or Administrative Committee for the Plan, the Company shall have a 90-day option to repurchase at your investment cost any shares in your escrow account at the time of such termination.

Thus, if your employment were terminated for other than the reasons enumerated above prior to the end of the fifth year after purchase of the shares, the Company has a 90-day option to purchase all your shares purchased under the Plan. If such employment termination occurred during the ninth year after purchase, the Company's option would apply only to one-fifth of your shares purchased under the Plan since four-fifths of the shares would have already been released from escrow by that time.

Conversely, if your employment were terminated by reason of your normal retirement, death total disability or early retirement with the consent of the Board of Directors or Administrative Committee while any purchased shares were still in escrow, all your shares would be released to you or your executor or personal representative, as the case may be, from the escrow and become unrestricted shares, the Company not having any 90-day option to purchase the shares.

Further, the Plan also provides that the restrictions imposed upon the shares purchased by you under the Plan will be removed in the event of the dissolution of the Company, or a merger or consolidation in which the Company is not the surviving corporation, or in the event your employment is terminated for any reason within two years after another entity acquires substantially all of the assets of the Company, acquires 20% or more of the outstanding voting securities of the Company, or merges or consolidates with the Company, except under certain circumstances where the Company is the surviving corporation.

While the shares are escrowed you will of course be unable to assign, sell or pledge the shares as collateral for a loan.

We ask that you send your check made payable to XYZ Corporation in the amount of the purchase price of your stock and execute and return the escrow agreement and assignment forms to the office of the Corporate Director of Compensation and Benefits, XYZ Corporation, promptly upon notification hereof in order that we may complete this transaction without delay.

Sincerely yours,

XYZ CORPORATION

By ____________________________________

President and Chief Executive Officer

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Exhibit 2: Guidelines for Restricted Stock Grant Based on Performance Appraisal

Restricted Stock Awards
Administrative Guidelines

1. Eligibility

All executives in Executive Pay Grade 4 and above are eligible to receive restricted stock awards.

Exceptions: If participant is within 12 months or less of age 65 or of known retirement.

2. Restricted Stock Award

By letter of agreement XX between the Company and the participant, issuances of Common Stock ($2.75 par value) is registered in the name of the participant XX which are subject to forfeiture and other terms, conditions and restrictions specified in the Letter of Agreement and the 1991 Stock Incentive Plan. The participant has the right to vote the awarded stock and receive dividends thereon. The participant shall not sell, assign, transfer, pledge, hypothecate or make any other disposition of any shares of the awarded stock until the restrictions lapse on the awarded shares. The stock is held by the Company, together with a stock power XX executed in favor of XX by the participant until the restrictions lapse. If the participant terminates employment with the Company for reasons other than death, total and permanent disability or the attainment of age 65, the participant forfeits his/her remaining rights to any of the awarded stock on which the restrictions have not lapsed as of the termination date and the shares on which the restrictions have not lapsed are returned to the Company for redistribution under the Plan.

3. Award Schedule

Employees are initially eligible for full awards when promoted, reclassified or hired into an executive position in Grade 4 or above on the executive payroll. The initial "recognition" award will reflect a met expectations performance rating and the appropriate matrix multiple (see Award Determination Matrix) will be used to determine the dollar value of the award.

At the discretion of the Compensation and Benefits Committee (the Committee) of the Board, full restricted stock awards will be given when all restrictions lapse on a prior full award (every four years).

Incremental adjustments are awarded when a participant, already in Executive Grade 4 or above, is promoted into a position which is in an executive salary grade with a higher multiple (see Award Determination Matrix). Incremental awards will be based on the participant's most recent performance rating and will have its own restrictions lapsing schedule applied as is in effect for full awards beginning on the date the award is given.

Exhibit 2 (continued)

4. Restriction Lapsing Schedule

Whether a full or incremental award, the restrictions lapse on 25% of the awarded stock per year from the first award anniversary date through the fourth anniversary date. Four years from the date of an award, all restrictions are fully lapsed.

If an employee should die, become totally and permanently disabled, or reach age 65, all restrictions fully lapse and cease to be effective as of the end of the month in which the employee's death, total and permanent disability or the attainment of age 65 occurs.

5. Award Determination

Awards will be determined by the following performance/salary grade matrix:

RSA as Multiple of Annual Salary Grade Midpoint
Most Recent Performance Rating

Grade	*Inadequate*	*Approached Expectations*	*Met Expectations*	*Exceeded Expectations*	*Outstanding*
15	0	0	1.36	1.84	2.32
14	0	0	1.36	1.84	2.32
13	0	0	1.12	1.60	2.08
12	0	0	1.12	1.60	2.08
11	0	0	0.88	1.28	1.84
10	0	0	0.88	1.28	1.84
9	0	0	0.64	0.96	1.36
8	0	0	0.64	0.96	1.36
7	0	0	0.56	0.88	1.20
6	0	0	0.56	0.88	1.20
5	0	0	0.48	0.64	1.04
4	0	0	0.48	0.64	1.04

The multiple from the above matrix will be applied to the participant's salary grade annual midpoint or base salary, whichever is higher, to determine the dollar value of the award.

The dollar value of the award will then be divided by the closing price of XX Common Stock on the day of the award. When this calculation results in uneven or fractional shares, the award will be rounded up to the next whole share.

Related Conference Board Publications

Corporate Directors' Compensation, 1992 Edition, Report No. 988, 1992

Top Executive Compensation: 1991 Edition, Report No. 983, 1991

Variable Pay: New Performance Rewards, Research Bulletin No. 246, 1990

New Strategies and Innovations in Compensation, Report No. 931, 1989

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The Conference Board

Report Number 998

Recruiting and Selecting International Managers

A survey of 130 multinational companies shows:

- *Companies are broadening the range of managers recruited for expatriate assignments.*
- *European firms take advantage of international business developments more quickly than U.S. firms.*
- *Most U.S. managers do not seek out international assignments.*
- *Human resource departments play a strategic role in recruitment and selection.*
- *Women are not proportionately represented in the expatriate corps.*

Serving Business and Society Since 1916

About The Conference Board

Founded in 1916, The Conference Board's twofold purpose is to improve the business enterprise system and to enhance the contribution of business to society.

To accomplish this, The Conference Board strives to be the leading global business membership organization that enables senior executives from all industries to explore and exchange ideas of impact on business policy and practices. To support this activity, The Conference Board provides a variety of forums and a professionally managed research program that identifies and reports objectively on key areas of changing management concern, opportunity and action.

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Recruiting and Selecting International Managers

by David A. Weeks

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About the Author

David A. Weeks is a former senior vice president of The Conference Board and Director of the New Jersey Center For International Business Education. Currently, he is president of Weeks & Associates, Inc., consultants in management development and organization.

From the President

For hundreds of multinational companies, building global awareness among all executives and providing firsthand international experience to fast-track managers are the key components of a competitive human resource strategy.

This report assesses how 130 U.S.-, European-, and Pacific-based companies internally recruit and select executives and managers for assignments abroad. The study looks at current trends and ahead to the problems caused by changing trade alliances, joint ventures, work force delayering, cultural prejudices and education.

We are grateful to the companies who responded to our survey and to the many executives and consultants who shared their insights with us.

PRESTON TOWNLEY
President and CEO

Executive Summary

For many businesses, the door to future growth eventually opens on international markets. Cost cutting is a defensive strategy that may hold the line against rising competition, but only a return to solid growth can ensure long-term success. And that growth will almost certainly have to be international.

This report looks at some of the techniques and organizational underpinnings for staffing international operations with expatriate and third-country national managers. The study is based upon a survey completed by 112 U.S.-, 13 European- and 5 Pacific-based multinationals. The leading-edge practices of these companies are discussed, and three special cases are presented so that programmatic efforts can be understood in context.

Finding executives, middle managers and even specialists with a global business orientation is the toughest part of the new strategy. For many companies, the recruitment of internationally experienced managers is centered in their own organizations. They are spending time, money and effort in selecting top performers for assignments abroad. Moreover, their human resource strategy is changing from what it was a decade ago.

For years companies have been cutting back on the use of expatriates (i.e., home country employees or third country nationals working abroad). Instead, the surveyed firms say they are expanding the number and types of executives and managers they are recruiting for foreign assignments. About half of the companies have more than 50 executives serving abroad, and 25 percent have between 200 and 2,000. The strategy is clearly to increase these opportunities.

While U.S. companies are rushing to develop an international cadre, European firms—which have been at home with the concept for years—are moving rapidly to capitalize on developments in the Common Market, Central Europe and Mexico. Many U.S. firms (45 percent) still think of expatriate assignments as fill-ins when a national manager is not available. Increasingly, however, they are re-engineering their succession plans and management development to push fast-track managers into foreign assignments. Only 42 percent of the CEOs in large, multinational U.S. companies have international backgrounds; significantly less than CEOs in non-U.S. companies. But the data show that the U.S. call to increased participation in international business is having an effect: Almost 75 percent of division heads and functional executives have some international experience.

There is solid evidence that recruiting is getting more difficult. Only 25 percent of respondents say their U.S. managers are eager for foreign assignments. Reasons cited are family responsibilities, spousal careers, and fears about the politics of repatriation. These make advance career planning a sound strategy.

As recruiting becomes harder, human resource departments are beginning to pull their own weight in the effort to globalize. Worldwide paperwork shuffling is still a hurdle; only 15 percent of the companies are getting help from their expensive human resource information systems (HRIS). However, more companies will be formalizing international management development programs, and many are hiring foreign graduate students and arranging temporary assignments abroad.

Human resource managers have another hurdle to overcome—women are still not proportionately represented in the expatriate corps. Top management continues to have problems communicating a consistent global vision about career progression. In many countries, such as Japan, the "ethnic glass ceiling" pushes many capable managers into other companies. In other countries cultural restrictions undermine female managers' effectiveness.

Finally, selecting expatriate candidates is still more an art than a science. Respondents rank tolerance and multicultural awareness on a par with business knowledge when they draw up lists of success factors. But new techniques for anticipating problems and improving exposure are beginning to pay off.

Regardless of the current level of effort and the partial successes, the picture is expected to continue to change rapidly. Most participants agree that investment in internationally experienced people has lagged, particularly in the United States. As trade blocs form for the economic competition of the future, investment is expected to increase in scope and in sophistication.

Method

A total of 130 multinational companies (112 U.S.-based, 13 European- and 5 Pacific-based) responded to The Conference Board's survey of 700 U.S. and large multinational businesses. Companies were involved in manufacturing, resource exploitation and services (including banking).

The tables below show the size and number of countries in which these firms operate. Survey respondents were vice presidents or corporate directors of international human resources. In-depth interviews with 13 senior human resource executives and consultants in the United States and Europe were conducted to provide insights into important trends in recruitment and selection of managers for international assignments.

Types of International Organization Structure

	U.S. Companies		*Non-U.S. Companies*		*Total*	
Type of Organization	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
Worldwide by Product Line	24	21	6	33	30	22
Global Matrix	23	21	4	22	27	21
Geographic Regions	19	17	3	17	22	17
Mixed (No Dominant Structure)	18	16	2	11	20	15
International Division	18	16	1	6	19	15
Mostly Export	8	7	2	11	10	8
Other[1]	2	2	–	–	2	2
Total	112	100%	18	100%	130	100%

[1] One company organizes by function; another is made up of affiliates.

Number of Expatriates

	U.S. Companies		*Non-U.S. Companies*		*Total*	
Number of Expatriates	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
200 or more	25	24	7	41	32	26
100 to 199	9	9	5	29	14	12
50 to 99	16	16	3	18	19	16
10 to 49	21	20	2	12	23	19
Less than 10	32	31	–	–	32	27
Total	103[1]	100%	17	100%	120	100%

[1] Nine U.S. companies and one non-U.S. company did not supply data.

Number of Countries

	U.S. Companies		*Non-U.S. Companies*		*Total*	
Number of Countries	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
More than 100	10	10	3	17	13	11
50 to 99	12	12	7	39	19	16
25 to 49	21	21	1	6	22	18
10 to 24	24	24	3	16	27	23
Less than 10	34	33	4	22	38	32
Total[1]	101[1]	100%	18	100%	119	100%

[1] Eleven U.S. companies did not supply data.

Adopting a Global Staffing Strategy

For the majority of U.S.- and non-U.S.-based multinational companies, building a globally oriented staff is a top priority. Most firms, however, continue to have problems in this area. The model each company chooses to recruit, select and develop international managers is influenced as much by the company's state of international development as it is by business organizational or environmental constraints.

Five Human Resource Strategies

Generally, the use of expatriate managers in senior or middle management positions is based on one or more of five human resource strategies. The level of position reserved for expatriates, degree of specialization, "training worth" of the job, units managed, and relationship of the expatriate job to the policy process are all dependent upon the strategy used (see Chart 1).

Control-Based Strategies

For most of the larger multinationals surveyed, expatriates are assigned certain jobs to insure that the central headquarters maintains control of company operations around the world. This is true for U.S., European and Pacific companies. Two kinds of control are frequently employed:

1. *Policy control.* Essentially, the company's senior level executive team and board of directors are of the

Chart 1: Strategies for Using Expatriates

MOVE TO GLOBAL BUSINESS

CONTROL BASED	Regional Executives Financial Managers Policy Executives
MANAGEMENT DEVELOPMENT	Technical/Scientific Managers Senior Broadening Fast-Track Development
EXPERTISE BASED	Operating Specialities Manufacturing Managers Process Engineers
RAPID EXPANSION	Service Managers Manufacturing Managers Marketing and Sales
JOINT VENTURE MANAGEMENT	P&L Executives Operating Managers Cost and Process Control

same nationality as the traditional ownership base. For some companies, this insures that most of the regional and product senior executives are expatriates of the home country. For the Japanese, it means placing Japanese executives in virtually every upper middle management position around the world. For the U.S.-based company, it generally means that U.S. expatriates will hold the regional profit and loss slots and the major staff functions.

2. *Control of results.* For many companies, including most of the older European-based companies, this strategy translates into employing experienced expatriates in the chief financial, manufacturing and technical production functions for virtually every national affiliate of consequence. On a temporary basis, U.S. firms generally dedicate jobs on a "start-up team" to expatriates when the company begins manufacturing in any part of the world.

For U.S. and Japanese companies, policy control is the most sensitive area, whereas, for Europeans, corporate results are crucial. In each case certain positions throughout the hierarchy are set aside for expatriates, usually from the headquarters' home country.

Developmental Strategies

The second most cited rationale for sending expatriates abroad is to develop the individual manager. For example, a major investment bank tries to move its young international bankers into foreign assignments as soon as they are able. But younger managers are not the only ones that need to develop a global perspective. An example is a machinery company that uses expatriate assignments to develop more senior managers through expatriate vice presidential level assignments that rotate an executive with little foreign experience between a Brazilian profit and loss (P&L) responsibility and a planning slot in Mexico before promoting to the corporate international staff.

In the past, expense was often cited as a limitation on expatriate assignments; today, while cost remains a concern, awareness of the future importance of world markets seems to be loosening many companies' purse strings.

Experience- or Expertise-Based Strategies

Another strategy limits the use of expatriates to positions where their particular expertise or, at the very least, their business experience, can be useful. The upstream exploration for oil in the Pacific and the marketing experience of food company executives in Kuwait, are examples of companies turning to expatriate strengths in a foreign market.

One pharmaceutical firm assigned a world-class biochemist to a series of different laboratories so that his ideas, theories and approaches might stimulate scientists already at work. This is also an example of a strategy requiring jobs to be set aside for expatriates—even if they are third country nationals (TCNs) who are not from the headquarters' organization.

Rapid Expansion Strategies

For some companies expatriates are the link to future international expansion—the leap from marketing *to* foreign countries to marketing *in* foreign countries. As they expand, these companies have increased international business through exports and are concentrating new energy on recruiting expatriates for key assignments abroad.

The Achilles' heel of this strategy may well be that credible candidates do not have any real history to indicate that such assignments—successfully mastered—do indeed build careers. Some of the firms committed to this kind of rapid expansion have also noted some hesitation—and consequent wavering of purpose—when markets are not immediately responsive to the company's overall plan. Others have remarked on executives' fear that being out of the company mainstream in times of rapid change is a harmful career move.

Joint Venture Strategies

More firms are using joint venture structures to enter international markets. Whether these are actual corporate entities or merely cooperative alliances, the tide looks unstoppable. For example, the much watched attempt by India to control the incursions of foreign-owned ventures ended in disarray on July 1, 1991. India has changed its laws to allow International Business Machines Corporation (IBM) to retain control of a joint venture with India's computer firm TATA. IBM had ceased operations in India in 1977 when laws limiting foreign companies' rights to control first took effect. Since July 1991, however, foreigners can now own 51 percent or more of a joint corporation. Since the new law took effect, IBM has been joined in India by a Ford Motor Company venture with Maruti, Ltd. for car parts. General Motors Corporation and Kellogg Company have also announced new ventures.

In Japan, access to the fragmented Japanese distribution system also often depends upon having a Japanese partner. In all of these markets, companies are turning to home country expatriates both to make the deals and to staff the resulting operations. The need to develop national managers is deferred because of the ready availability of the partner firm.

Two negative trends seem to be emerging when a joint venture strategy is followed. First, the expatriate managers can find themselves on different sides in policy disputes from their compatriots in the corporate headquarters. For example, in Japanese/U.S. joint ventures in the computer industry, the right to license and produce components by these giant partnerships is sometimes challenged when U.S. companies charge Japanese firms with "dumping," that is, selling in U.S. markets at prices below their home market value. Second, the costs of living for the joint venture executives can be very high after extensive negotiations and business trips evolve into unique living arrangements for the staff and their families.

Selecting Executives

The strategy for recruiting and using expatriate executives, managers and specialists depends upon the way an international company is organized, the number of countries in which it operates, and on the skills, experience and international view of the executives involved (see boxes on this page).

The respondents in the Conference Board survey run the gamut from complex matrix organizations to large export divisions. Thus, the use of expatriates and extent of operations are considerably varied. Numbers range from thousands of expatriates to less than 10, from operations in 120 countries to operations only in North America.

Companies that have already evolved to complex global organizations tend to have proportionately fewer expatriates from the home country and more TCNs in their worldwide operations. Companies with operations in 20 to 35 nations and significant aspirations for further growth seem to be leading the way in establishing developmental assignments. Companies where initial expansion is well under way tend to have more high level and policy executives on overseas assignment. (The sample was not broad enough to determine the role of other important variables, such as industry and

Profiling Global Commitment and Awareness

Companies are beginning to ask some hard questions about themselves as they move more deeply into creating world-class organizations. Try your company out against these indicators.

1. **Is top management continuously stressing its desire to become a global competitor?**
2. **Are corporate values in tune with each of the country cultures and business environments in which you operate?**
3. **Are there increasing numbers of task forces with executives from around the globe? Does the board of directors have members from different nations? Does it meet only in the headquarters city?**
4. **Does the company host many international events, meetings and conferences? Do top executives travel constantly to international affiliates?**
5. **Are training dollars invested in language training and cultural orientation for wide groups of employees or only those going abroad?**
6. **How aware are managers of cultural diversity and of the effects of stereotypical thinking on the way they manage and communicate?**
7. **How much do managers know about global competitors and what it will take to outperform them?**
8. **How much senior executive time and attention is devoted to the international aspects of staffing?**

Are You Developing Globally Aware Executives?

Certain pulse points in any international organization can yield solid clues about how effective the company's efforts are at recruiting and selecting managers for international assignments. The companies that are most effective take care to:

- **Insure that international staffing has the attention of senior management. For many of the companies, this means a formal review of the readiness and assignment performance of expatriate managers. At some companies, it also may mean assigning staff responsibility to a single director of international human resources to act as advocate as well as information resource to senior executives.**
- **Test information and communications systems to make certain that information on TCNs and home country expatriates is included and up to date. These systems have fallen short of the needs of many growing international companies.**
- **Get succession plans out of the president's desk drawer and make sure that they contain current information about international experience. In addition, ensure that international assignments are a factor in assessing the overall readiness of the company's fast-track people. Preparing and developing global managers requires long-range planning.**
- **Use counseling sessions to encourage young managers to expect and commit to international assignments as a normal career development strategy.**
- **Make sure that decision-making on the use of expatriates and TCN managers is left to the operating managers; however, remind them that they will be evaluated on how they help the company develop globally minded executives for the future.**
- **Fit staffing approaches to the level of the management job. For senior level executives, this may mean short assignments which don't necessarily follow all the policies and paperwork rules. The chief responsibilities for more junior people are defining career tracks and making sure they are considered for openings around the world. These challenges are best approached on a system-wide basis.**

Table 1: Have Company's Top Executives Been Assigned Outside Home Country?

	U.S. Companies [1]		Non-U.S. Companies [1]	
Executive Level	Number	%	Number	%
Chief Executive Officer . .	47	42	11	61
Board Members	51	46	12	67
Division (SBU) Heads . .	73	65	14	78
Functional Heads	76	68	11	61

[1] Based on 112 U.S. companies and 18 non-U.S. firms.

reliance on profits from international operations, in the propensity to use expatriate managers.)

Changing Corporate Expectations

In many major corporations, the '90s are being called the decade of globalization. Large sections of company annual reports and strategic planning documents are devoted to this subject. According to this study, globalization rhetoric for the most part is just that: a statement of strategy and intentions from major corporations. For U.S. and Japanese companies there seems to be somewhat less reality behind the global point of view than in the case of European-based multinationals. For many expanding companies, such talk is also a bit premature during these recessionary times.

From a human resource perspective, whether a company's management becomes truly global in its outlook depends on many things: the reinforcement provided by the leadership; past cultural and business experiences of the CEO; the depth and background of its board members; the commitment and skill of its functional and staff executives; and the amount of time it has been actively at work on globalization.

As illustrated in Table 1, survey results show evidence that a great change is occurring:

- Of the 130 companies, 42 percent of the U.S. CEOs and 61 percent of the non-U.S.-based CEOs have already had substantial international expatriate assignments.
- Slightly more, 46 percent, of the inside board members of U.S.-based corporations have had international P&L responsibilities compared with 67 percent of the non-U.S. companies.
- At the divisional level, an even brighter picture of the progress of globalization occurs: Some 67 percent of both U.S. and non-U.S. companies' major divisional executives have been expatriates.
- Sixty-seven percent of the companies report solid experience for financial, marketing and human resource executives.

Considering the fact that the surveyed firms are in the vanguard of globalization efforts, the U.S. results are not overly impressive. Most U.S. companies still refuse to share the boardroom and the executive suite with foreign executives, but European companies are more open. Europe's edge may reflect large blocks of foreign ownership in their multinational companies. This, in turn, may be conducive to a more global management perspective. In addition, since so much of the sales and profits of European-based multinationals are outside the single European home country, a multinational attitude has had much more time to take hold in these firms. Finally, these European-based companies have much more international business experience than most of the U.S. companies (see box, above).

Keys to Building Global Perspective

The following is advice from the survey panel of experienced human resource vice presidents.

1. **Make international assignment planning part of career planning.**
2. **Constantly communicate the value of international assignments to the company's global mission.**
3. **Review fast-track candidates with foreign management before assignments open up.**
4. **Involve senior executives with consultants, readings, visits and conversations with counterparts from foreign firms.**
5. **Provide well thought-out development assignments under a year in duration for managers and functional specialists.**
6. **Recruit foreign-born students at local business schools and technical universities.**
7. **Begin international assignments earlier in managerial careers.**
8. **"Lead in to" and "follow up" expatriate assignments with other international assignments at home.**
9. **Make contacts with international recruiting firms here and abroad.**
10. **Invest time and money in a usable HRIS international system.**
11. **Review existing travel, living arrangements, and foreign service premiums to see if costs can be further controlled.**

Matching Executive Skills to Business Strategy

Respondents report broad changes in the level and type of manager or executive they feel could best represent the corporation in its world mission. According to these executives, the most important lesson of the last five years of international business growth is that companies should spend more time and care matching executives to the expatriate jobs (see box, below). For the increasing number of multinationals who are beginning to think globally, the major challenge is to turn away from their previous model—a collection of international business operations and affiliates operating in discrete, "foreign" countries. Both U.S.- and non-U.S.-based firms are struggling with this shift. For a third group of companies—those that have decided to expand international business rapidly beyond a single country where they have experience exporting—the struggle is to move away from the concept of the international executive as a kind of exotic functional specialist in regulations, tariffs, shipping and international finance.

Patterns Changing for Global CEOs

For global companies, the vision put forward by their leaders must have international scope. Respondents say that the plan offered by the CEO to make the company a world-class competitor should come out of the leader's personal international business experience. Many of the surveyed companies say they are looking forward to the day when a truly international cohort of top managers reaches the policy level in their companies.

The human resource executives in the survey agree that ideal top executives in a world-class company should be:

- Free of national prejudices; they will have to demonstrate that they possess a global rather than a nationalistic orientation to people, custom and business opportunities.
- Knowledgeable regarding world marketing pressures, global resources and funding sources.

Who Gets Selected for Globally Aware Assignments?

Assignments outside the country are not for everyone. What the reporting companies are trying to achieve is a systematic change toward an internationalist mindset in its future leaders. While many managers are selected for overseas assignment for predominantly developmental reasons, these assignments are not created for that purpose in most companies. Essentially, the case studies and the interview data show that four major considerations help to define the job/employee relationship:

1. The international business needs of the company are still key. Fast growth abroad means more expatriates in key jobs until a pool of national talent is developed. Once a long-term future is assured, a continuing stream of managers from many countries is needed to understand the businesses and the business cultures in all of the operating countries.

2. The individual's past performance at home and in other assignments abroad is the principal selection criterion. Family acceptance, language skills and cultural adaptability play a part in the decision, but without the ability to do the job an expatriate would be lost in the foreign organization.

3. Coaching younger managers can help them develop the characteristics of flexibility and multicultural skills before they are formally offered their first job abroad. At the same time these early discussions force employees to begin talking with wives or husbands and children about the family's ultimate response to assignment abroad.

4. High potential managers must be tracked *while* they are in assignments outside the country as well as before assignment. Finding these performers and giving them visibility worldwide is a major preoccupation of human resource professionals. Enlisting the help of senior overseas executives and personnel people as well as improving international record-keeping systems are key to success.

- Involved, alongside major competitors, with political and regulatory developments and opportunities in major countries of importance to the company's operations.
- Comfortable with almost perpetual motion to reinforce the global mission and evaluate the executives who are making it a reality.

Operating Executive Skills

For the regional and product-line operating executives, a strong reliance on teamwork and team leadership is the pre-eminent qualification at the large globally oriented firm. Thus, marketing, developing new products, sourcing components and materials, and establishing new ventures are increasingly the function of international teams. These teams are not always led by executives from the home country headquarters.

According to human resource executives, teams increasingly include line executives from a number of countries as well as some functional specialists and financial people from headquarters or even from a subordinate business unit (SBU). In some service and banking firms, the teams are constructed internationally as a kind of extension of the "national account" organization of many large banks. These teams can quickly tap resources from separate country organizations and remain responsive to a "worldwide account."

Overall, in the global corporation of the '90s, operating executives will need to maintain:

- Heavyweight organizational networks within their own firms, so that they can stimulate action with a phone call or facsimile.
- Confidence in their own authority and ability to use it without hiding behind bureaucratic walls.
- Strong analysis of propositions and opportunities. They must get legwork done quickly in many countries and be able to understand headquarters' priorities and limitations.
- Awareness of competitors' plans, not only for marketing, but for business strategy, growth, and possible future combinations in the marketplace. This implies a heavy dose of effective time spent with industry and trade association people, as well as the ability to set up and use competitive intelligence systems.

Management in Expanding Companies

Among the surveyed companies yet to arrive at a global view of themselves, the principal need is to recruit or develop managers with some international experience. In many such firms, the initial decision to expand internationally is made by the CEO and the board on the basis of specific opportunities: Should we build a "twin" plant in Mexico? Can we economically distribute software in France? Can our labor costs be cut by making our telephone handsets in Taiwan?

Success in a few early ventures feeds the desire for more rapid expansion in more than one international theater of operations. According to the human resource directors, the first international steps are usually a combination of outside hires using international recruiting firms and the transfer of a few marketing and operating executives from the headquarters' company. These expatriate managers should have:

- High energy and an appreciation for the need to work at top speed at a wide variety of tasks since communications, contacts, interviews and space acquisition all take more time in foreign cultures than in our own. For example, the pace of business introductions and the establishment of credit relationship is much slower in Belgium or Japan than in the United States.
- The ability to work alone and to take prudent risks.
- A knowledge of techniques and resources that the business can use in various markets.
- The sales ability to build from a few established customer relationships a link to sign up a small group of new customers.

The human resource executives feel that while flexibility and persistence are desirable characteristics for expatriate managers, impatience and aggressiveness do not pay dividends. The strategy of rapid expansion in multinational markets is not really analogous to the introduction of a new product at home. The human resource executives warn that increased selection ratios are in order for these new hires, and that less concern with expense per expatriate will enlarge the chances of successful recruitment.

Transnational Communication Is New Emphasis

Whether the strategy is a nearly global approach to business or a more defined market-by-market approach, one need remains paramount: The objective must be not only to find executives with the requisite vision and personal skills, but also to build the ability of the resulting international organization to exchange information and to work together to solve problems across country lines. Modern communications and facilitation from headquarters can set the stage, but leadership specifically aimed at such a goal is also required at the senior level.

Among most of the larger firms in The Conference Board's study, global staffing is already in progress. More than 8 out of 10 major firms are already committed to using national managers whenever possible, but in every organization some jobs are reserved for expatriates from either the headquarters home country or TCNs. One German-based multinational makes it a practice to install "four eyes" in every national organization it puts in place. The CEO in each organization is a national of that country, supported and monitored by a pair of operating eyes and a pair of financial eyes, which are always German.

Among the companies surveyed, however, 85 percent of the U.S.-based multinationals and all of the non-U.S.-based companies are intent on building a broad, multilevel pool of managers with firsthand experience at managing abroad. In many ways, this build-up counters the trend of the past 20 years to use national managers. The new strategy involves both operating positions and developmental assignments. It is an effort designed quite consciously to give new international business perspective to companies at all levels of international sophistication and complexity.

Why Is Demand Increasing for Expatriates?

For the majority of surveyed companies, expatriates are used when the local organization abroad could not come up with a suitable candidate for an open operating position (see Table 2). The next best option is to ask the headquarters to find and relocate a candidate to handle the job for two or three years, depending upon the promotability of younger national managers.

As Table 2 shows, 20 percent of the respondents have increased the use of expatriates because they feel that individual career development requires firsthand experience managing abroad, or at least working in a foreign culture for a period of time. The assignments range from year-long orientation assignments for Japanese rotational employees to the transfer of a top-line oil company executive with little overseas experience to a stint as regional general manager for Latin America. The objective is to groom the executive as a potential top policy executive in five years.

For a giant U.S. financial services firm, since service introductions in Europe are so specialized in terms of marketing skills, an experienced professional from the United States was relocated to lead the national team. The pace of service introductions had speeded up radically in the last two years, and so more U.S. expatriates than usual were being relocated.

A large group of companies report that they have increased their expatriate group because their business strategies have changed—they are manufacturing abroad for the first time, they are entering Pacific markets from a joint venture in Australia, or they decided to globalize vendor-suppliers, resource purchasing, logistics, or other functions that needed home country experts.

Another group of companies cite changes in the Common Market or increased business prospects in the reviving Central European economies as the prime reason for sending a variety of senior executives and specialists to Europe for the next few years. A handful of respondents say their main reason for changing to international short assignment is the need for a pool of internationally experienced senior executives to succeed current management.

Table 2: Reasons for Assigning Expatriate Managers

	U.S. Companies		Non-U.S. Companies	
Reason	*Number*	*%*	*Number*	*%*
No national manager available	50	45	3	17
Corporate strategic growth requires	35	32	11	61
Part of career development process	22	20	4	22
Creating international specialist corps	4	3	–	–
Total	111[1]	100%	18	100%

[1] One company did not supply data.

Science a Special Case

For most U.S. firms, R&D employees are not yet heavily involved in longer duration foreign assignments. In European-owned firms, they are more likely to go abroad. Science and technology employees, however, are increasingly involved in short-term assignments as project advisors to a foreign group. Each of the chemical and pharmaceutical companies interviewed points to a declining pool of U.S. scientists as a reason to bring more scientists and engineers from foreign laboratories to the United States. Several of these firms are even embarking on concerted programs to hire scientists and engineers on a world-market basis.

Foreign Service Concept Dies

In the 1970s and 1980s, a number of major companies formed a "Foreign Service." The philosophy was that a relatively small group of employees would be effective in international assignments. Once a first assignment was successfully completed, the employee was asked if he or she would be interested in developing a career in the international end of the business. If the answer was "yes," the employee and family could look forward to several assignments in different countries before any repatriation would take place. The life and even the compensation of these employees was modeled on the United States Foreign Service or diplomatic corps.

This concept is no longer prevalent among major companies. Only four firms in the survey mentioned that they were fielding a number of executives to build a group of international experts and specialists (see Table 2). The strategic need to globalize the perspective of all the managers in today's world-class company has put an end to the idea that international management is, like personnel management, a narrow speciality.

Shifts in a Firm's Center of Gravity

Many of the cooperators also indicate that they had recently been forced to change their traditional center of gravity in terms of important world markets. For some, this shift is related to geographic developments, for others, it is a matter of deciding where to manufacture and how to structure their businesses. For example, companies operating in Europe must ask: Will the Common Market be only part of a European region including some or all of the emerging eastern European countries? For other companies, involved with global resources, such as oil or zinc, prospects can now be enlarged to include the former Soviet Union or Canada.

Most of the surveyed firms are still organized according to an essential national structure with a few regional headquarters around the world; however, these regions are changing. More and more third country national executives are moving into positions once exclusively the property of home country nationals.

From the standpoint of management succession planning, some of the responding human resource executives are opting to establish a development and competency plan within regions, rather than globally. When the Common Market or a North American free trade agreement are established, companies will certainly require more expatriates in the early years than they will later. New trade regulations in these areas have yet to be fully taken into the planning of respondents. Companies are aware, however, that old patterns may have to be revised in the next 10 years.

The Individual and the Expatriate Assignment

Global competitive strategies, trends in the business environment, even the performance of the human resource function, all contribute to the company's success in recruiting managers, executives and technical people for international assignments. However, most of the respondents agree that the situation of the individual employee is the crucial factor.

International Jobs Take More Thought

In 68 percent of 128 companies responding, human resource directors indicate employees may have some hesitancy about the value of expatriate assignments to careers in the new global company. Only 29 percent of the companies report that the majority of their managers have wholeheartedly accepted the necessity of international assignment in their career development. However, only 4 percent of the U.S. companies feel that most employees offered assignments are totally opposed to going abroad (see Table 3).

No ready explanations exist as to why so many companies find their high potential managers reticent to take international posts. One possibility is changing values: Younger male employees have resolved to put family first; women want international assignments, but only in certain countries; and senior managers hesitate to uproot teenagers. The consensus is that a great deal of soul searching will continue to be the norm when expatriate opportunities come up.

Table 3: Willingness to Accept International Assignments

	U.S. Companies		Non-U.S. Companies	
	Number	%	Number	%
Will generally accept	29	26	8	44
Will consider offer	77	70	10	56
Unlikely to accept	4	4	–	–
Total	110[1]	100%	18	100%

[1] Two U.S. companies did not supply data.

This attitude contrasts with the expectations of companies in other countries. In a Japanese firm, the human resource managers have to be very careful because "rotational assignments are considered a plum and the key to further promotion in the business." A vice president of a Swedish firm states, "Assignments abroad are the heart of our business, and this experience is necessary for those who will rise to senior management positions."

Success Factors for Expatriate Managers

The high cost of sending and maintaining expatriate managers abroad worries many human resource directors. While rigorous research appears to be lacking, many of the most experienced international vice presidents and directors generally agreed on the experience and background factors professional recruiters look for in successful international candidates (see Table 4).

Table 4: What Makes Expatriate Managers Successful?

	U.S. Companies		Non-U.S. Companies	
Attribute	Number[1]	%	Number[1]	%
Flexibility and tolerance	58	52	10	56
Knowledge of business	58	52	10	56
Interpersonal skills	48	43	13	72
Past job performance	51	46	8	44
Traveled and lived abroad	36	32	2	11
Eagerness to work abroad	35	31	3	17
Language capabilities	29	26	5	28
Results-oriented management	25	22	2	11
Spouse not employed or single	7	6	–	–
Degree in international business	6	5	–	–

[1] Based on total number of mentions from 112 U.S. companies and 18 Non-U.S. companies

Flexibility, Tolerance and Interpersonal Skills

Executives agree that flexibility and tolerance are equally as important as the candidate's knowledge of the business during assignments abroad. More than half of all respondents mentioned these two key characteristics.

Some 72 percent of the non-U.S.-based firms listed interpersonal skills as the most critical factor in expatriate success. Only 43 percent of the U.S. firms put this factor as high on the list. European managers seem to pay more attention to business contacts, industry contacts, and governmental relations than U.S., Japanese or other Pacific Rim companies.

Job Performance Is the Key

For 45 percent of the companies, past job performance is one of the strongest indicators of future success. What is more, the job performance they are referring to is not necessarily successful completion of a previous international assignment. In fact, few companies have created a career foreign service employee group. One or two three-year assignments abroad after a manager has been with the company for about four or five years is the pattern today. The companies rely extensively on past performance evaluations, assessment center results, management training program success, and other quantifiable measures of the candidate's performance as the key inputs sent to the hiring manager.

Experience Abroad

Another factor is experience abroad. Somewhat less than 30 percent of respondents say they look carefully at the candidate's background sheet to see if he or she lived, studied or traveled extensively in the geographic area of the assignment. Parents in the military or in international business might also be an indicator that the cultural and language adjustments might not be such a great shock.

The 29 percent of the respondents who say they try to assess eagerness to work abroad point to the candidate's dedication to international assignments as a career-building strategy. The eagerness should come, they say, from knowing that international experience is a valuable commodity in the new global corporation.

Language a Factor

The data clearly show that U.S. executives do not consider foreign language capability a sine qua non of international business success. They say this attitude is not "Ugly Americanism," but a realistic appraisal of world business practicalities. U.S. expatriates abroad find that much of their on-the-job office time is spent working in English. National managers generally have a ready command of English from their schooling and much of the internal correspondence is in English.

For the Japanese and some continental firms, the picture is different. Most of their managers cultivate English as the language of business. In German and French multinationals studied, the headquarters language is the required tongue for all executives who are TCNs, and senior executives are encouraged to learn them.

All of the recruiters agreed that learning the host country language was a must for the families of expatriates. (This was the common wisdom even among oil companies, which have been notorious for forming U.S. enclaves in foreign countries.) For wives and children, the minute-to-minute give and take and their ultimate adjustment often depends on language capability. Almost all of the companies in the survey support language instruction both before and after the expatriate family relocates to a new assignment. One company even cited failure in the advance language classes as a reason why some of its families turned down foreign assignment.

Management Style May Have an Effect

One area of considerable disagreement among internal recruiters is whether a manager's previous success with a results-oriented management style is a liability or a success factor. Twice as many U.S. managers picked this factor as important to success as did European managers.

Almost all recruiters interviewed cite horror stories which turned on the failure of a no-nonsense, push ahead management style in Europe. Many warn that the pace and even the spirit of business around the world is usually at odds with the aggressive management style preached in large U.S. companies. Japanese companies fault both European and U.S. companies for forming partnerships with Japanese firms and then ignoring advice on how to enter their markets profitably.

For smaller companies whose strategy abroad may be to expand rapidly and systematically, such a style might have some merit according to recruiters. However, when dealing in Asia or the Middle East it is a definite negative factor. This is often because the style relies upon setting and monitoring very short-term objectives. Such differences in style are often cited in explaining the abortive joint marketing venture in the U.S. between AT&T Company and the Olivetti Company.

Spouse's Career

For a family to succeed in an expatriate assignment, the spouse's career and adjustment are also crucial. For seven of the respondents, single, divorced or even very young candidates had the edge. The same thinking was applied in the case of non-working wives by some respondents. U.S. human resource policies in the United States against discrimination by race, sex, marital status and age may be masking the true use of these considerations in arranging international assignments.

Table 5: What Makes Key Executives Successful?

Attribute	Most Important Number	Most Important Percent	Second Most Important Number	Second Most Important Percent	Third Most Important Number	Third Most Important Percent
Overall past performance	52	40	27	22	16	14
Teamwork	43	33	42	34	20	17
Specific knowledge of situation	20	15	28	23	35	29
International business experience	9	7	15	12	29	25
Language	6	5	11	9	18	15
Total	130	100%	123	100%	118	100%

Key Executives' Past Performance

A similar respect for both business knowledge and teamwork abilities comes out when the respondents identify the criteria for successfully filling an executive P&L position. About 44 percent of the U.S. and 47 percent of the foreign-based respondents emphasize determining the executive's overall past performance record. About 35 percent of the U.S. and 47 percent of the Europeans thought that an executive's ability to work with the company's local, regional or corporate business team was the key factor to success (see Table 5).

Familiarity with the specifics of the foreign business situation was mentioned as most important by about 15 percent of the U.S. managers, but by fewer non-U.S. respondents. An executive's international business experience was downplayed by most of the respondents. Whether this situation will change in five years, after many international transfers have already taken part in international development assignments, remains to be seen. If a difference cannot be noted, some serious questions may be asked about the time and expense of these increasingly popular international assignments.

As expected, language abilities are not considered critical to success at the executive level either. However, without knowing the local language it is difficult for senior managers to integrate daily business news with the small facts and rumors that contribute to business intelligence.

Why Employees Balk

Table 6 summarizes the top reasons why even high potential people may reject assignments of a year or more abroad; they are family considerations, fear of repatriation and career damage, and role of the working spouse.

Family Considerations

Family lifestyle provides the main source of objections to transfer abroad. Living conditions, education and health of the children and the necessity of providing care for aged parents are the principal reasons cited in this category. Many respondents say that the spouse's inability to leave his or her career is a growing reason for turndowns.

The most frequently cited reason employees reject international assignment is that their life conditions make relocation inadvisable at the time the offer is made. To reduce the possibility of assignment rejection, many companies are introducing the desirability of international experience early in career planning sessions. If an employee objects during the career planning phase, many surveyed companies will advise the manager to seek a career elsewhere. In another group of firms, refusal of an international transfer is seen only as a change in career direction; the employee is still considered able to contribute to the corporation. The longer a company is multinational, the more it is committed to global management rhetoric, and the more pressure it exerts on employees for cooperation.

For persistent health problems, most companies are very understanding. For education-connected problems, U.S. and European firms are less inclined to accept a rejection or postponement of an international assign-

Table 6: Reasons Given for Rejecting International Assignments

Reason	U.S. Companies Number	U.S. Companies %	Non-U.S. Companies Number	Non-U.S. Companies %
Family lifestyle	59	56	13	72
Career damage/ repatriation fears	26	24	1	6
Spousal career	15	14	3	16
Not seen as crucial to career	4	4	–	–
Language difficulties	–	–	1	6
Total	106[1]	100%	18	100%

[1] Six U.S. companies did not supply data.

ment. However, since Japanese multinational human resource managers hear so many complaints about inadequate U.S. education, they have established subsidiary education systems to prepare students for admission to Japanese colleges. On the other hand, U.S. companies often pay substantial travel expenses to enable children to attend college in the United States.

In interviews, a few recruiters said they sometimes revisited the question of family readiness to relocate, and offered a second assignment three to five years later. Most, however, said they considered refusal enough to disqualify the employee from fast-track consideration.

Only one or two executives thought family values have shifted away from foreign assignments even at the risk of limiting career prospects. In most of the surveyed companies, international travel and assignment abroad are perceived as a way of life. In addition, at least in the case of younger employees, some self-selection affects involvement in global business.

Senior employees and older employees are harder to convince according to recruiters. More diverse family concerns and more knowledge of alternate career avenues are cited as reasons. A handful of companies provide only short-term development assignments to this group. Other companies are trying to increase global awareness through assignments in international division headquarters where relocation abroad is not involved.

Fear of Repatriation and Career Damage

The specter of a difficult job adjustment at repatriation time, complicated by the feeling that it is not good to be out of the corporate mainstream, deters others. According to the HR directors, here a change has occurred: in the '70s and '80s, bad experience with repatriation usually centered around economics. For example, a house would be unaffordable for a U.S. executive who, after 15 years abroad, had not benefited from the appreciation of earlier home purchases.

Today, many objections also center around career development. For example, a laboratory manager was sent abroad to establish test centers in Italy and France. When he returned after six years to the United States, he found he was not even considered for the position of vice president of research after reorganization during his second expatriate assignment. Particularly in companies that suddenly shift corporate culture and set up more horizontal organization structures, repatriated managers are disadvantaged by their distance from headquarters and their corporate mentors.

Many of the firms in the survey have become aware of this problem. They are addressing it by:

- Investing heavily to make sure that their HRIS are capable of keeping track of international expatriates.
- Introducing more group review of prospects for promotion so employees that are not well known at headquarters are fully assessed by top managers.
- Guaranteeing certain jobs, locations or even promotions upon repatriation. These promises are made before the employee accepts the international transfer.

Role of the Working Spouse in the United States

The changing role of women in the U.S. workplace is part of the concern many employers have as they try to create a pool of experienced international managers. For example, more married women work outside the home today than ever before. The average male U.S. corporate manager between 28 and 35 is likely to have a spouse who is not only working outside the home, but who is also developing a career of her own.

Two problems surface when such couples consider international assignments. One is the potential reduction in income if the spouse is forced to stop working. The other is the reluctance to lose career opportunities and promotions while on foreign assignment. Several solutions have been tried by responding organizations:

- *Pre-planning career moves* by both spouses. In the multinational company detailed advance planning can narrow the timing of such assignments down to certain career stages. Preplanning is most likely in developmental assignments for fast-track managers.
- *Job hunting for spouses* is conducted to some extent by many of the experienced multinationals. They admit that language capability is a problem for U.S. spouses, and that tight working permit regulations are barriers to jobs in the United States, Germany and other countries.
- *Internal hiring of spouses* by the national organization. This is used particularly in those cases where both spouses work for the same company; however, it is limited by company size and the spouse's level of position attained back home. Some firms allow inflated foreign service premiums in pay and housing allowance to cushion the shock of lost spousal earnings. Others counsel the couple closely on the career importance that successful international assignments will have for future promotions and earnings.

In addition to these attempts to ameliorate the problems caused by spousal careers, some interviewed U.S. executives indicate that companies have shortened international assignments. As a result, they become six or eight month business trips with no dependent relocation, but with additional travel money available for visits.

Restrictions on Women

Among service companies and banks, and in marketing assignments among manufacturers, concern about the experiences of women executives in international assignments is growing. Some firms, such as those in oil exploration companies, have only one or two female expatriates in administrative jobs working abroad. This number is low not only because fewer women are involved in this aspect of the industry, but also because some countries refuse to allow women to work effectively in corporate roles. In service firms, however, many fast-track women managers need and want international experience. Among these firms, past negative experiences in some countries and almost inevitable spousal resistance combine to reduce the number of opportunities and candidates for international assignment.

The problem is mainly anticipated by U.S. firms, which are more concerned with the needs and experiences being offered to female managers. In addition, U.S. firms are encountering great difficulty bringing foreign born females into U.S. jobs. As one vice president states, "We have a major league multicultural problem with women, but it has to do with how we manage women scientists in our American laboratories!" The company has retained consultants to work with a polyglot group of managers and project leaders concerning the cultural acceptance of women scientists.

Service firms report that women managers are beginning to press for more international assignments in their careers. As more firms explore what can and cannot be done with international development assignments for women executives, these limitations may become more serious. However, only 12 of the respondents have had significant problems to date with women on assignment, and they feel that personalities were just as important as cultural acceptance of women in positions of authority.

Role of Human Resources

Well conceived and consistently executed strategies of international management development are the bedrock upon which large companies depend for successful internal recruiting of managers, specialists and even more senior executives to lead their world business at home and around the world. Companies are beginning to realize that both individuals and organizational competencies must be honed and assessed from an international mission standpoint to make a company a world-class competitor.

In each major industry group, some leading companies have put in place systems which are beginning to yield increasing numbers of candidates who have some international management experience and cultural knowledge combined with a sense of organizational oneness and a practical appreciation of how to deal effectively in that organization.

Task Defined

Senior managers speak about their activities in globalizing their companies in many different contexts; however, the common denominator mentioned again and again is the central role that must be effectively and imaginatively played by the human resource function (see box on pages 24-25). According to respondents, management assisted by the development staff must:

1. Reassess the expatriate managers and executives now working around the world and reintegrate them in the new global organization. This evaluation will yield both a consensus about these employees and a profile of success for future expatriate candidates.
2. Create a human resource strategic plan and meld it into the corporate and business unit plans. The survey clearly shows that failure to accomplish this task explicitly or to hold to the priorities established by the plan make both recruiting and developing international managers more difficult.
3. Sponsor global awareness and encourage a world business perspective among executives and managers in the company. Support this with communications and information systems that will allow information flow and open sharing of intelligence without specifically involving headquarters.
4. Involve fast-track managers and others who work in international business in multicultural training. Plan careers with the idea that future leaders of the company should have an international perspective based on realistic experience abroad.
5. Follow up all developmental assignments and make sure that repatriation is not an afterthought but a regular part of succession planning.

To test the penetration of strategic planning for the globalization of management, the study looked at the various tools, described below, that HR managers routinely use to plan and improve the management ranks. If those procedures showed evidence of having been modified to better assist in the internationalization of managers and the selection of expatriates, then we could infer that a concrete move toward globalization was occurring. While leading HR professionals have begun to implement this international strategic thrust, they have, by their own account, not been wholly successful.

Succession Plans Show Internationalism

Among the large corporations studied, about 71 percent employ the techniques of formal succession planning. In fully 87 percent of these firms, the updated plan contains detailed information about international background and expatriate assignments held for the corporation. Regardless of how the profile information influences hiring, the communication of international histories to all senior managers is a large step forward toward institutionalizing the value of international experience (see Table 7).

International Management Development Programs

Another area HR executives can control is the content of the executive and management training. Changing these programs in a significant way often requires two years or more of hard work and experimentation. While this task is far from complete, it is under way.

Table 7: International Candidates Included in Succession Plan

Included in Plan?	U.S. Companies Number	U.S. Companies %	Non-U.S. Companies Number	Non-U.S. Companies %
Yes	68	88	12	80
No	9	12	3	20
Total	77	100%	15	100%

Table 8: Companies With Formal International Management Development Programs

Have a Program	U.S. Companies Number	U.S. Companies %	Non-U.S. Companies Number	Non-U.S. Companies %
Yes	28	25	7	39
No	83	75	11	61
Total	111[1]	100%	18	100%

[1] One company supplied no data.

Twenty-five percent of the U.S. firms have inaugurated special programming designed to produce or improve the international management knowledge, cultural skills, language, or business knowledge of some or all managers nominated for complex residential management development schools, seminar programs, travel and special assignments. In contrast, 39 percent of the non-U.S.-based companies in the survey have already made progress toward a thoroughly integrated internationalist point of view in their formal management development schools (see Table 8).

Human Resource Information Systems

The average size of the participating companies would augur the use of large computerized human resource information systems for records, evaluations, pay, training and other programs. The bulk of the firms had such systems up and running. However, as Table 9 shows, only 15 percent of the U.S. respondents report that these systems were very useful in supporting the data needs of managers considering hiring expatriates for open positions.

The main reasons given for this shortcoming were:

- The HRIS was designed and installed before the company made a strategic decision to improve its world business perspective.
- The HRIS was designed mainly for compliance reporting and stops at U.S. shores; foreign data may be added in the future.
- Data in the system tends to be out of date.
- Since participation in the HRIS is voluntary and a number of divisions chose not to participate, job records are always incomplete.

From the standpoint of the operating manager who might want to hire a foreign national with top credentials, good performance reviews, and useful special skills, the human resource information systems of most companies are not the place to start.

HR executives are spending freely and devoting many hours to remaking their systems in the light of the need for more international information. European companies are in no better shape than U.S. firms. Most forecast that their efforts will not show strong results until 1995.

Help to Hiring Managers

Because so many tools are not yet in place, the hiring manager in an overseas division is still very likely to hire only nationals of his country. As Table 10 shows:

- Fifty-eight percent of the respondents routinely provide foreign hiring managers with the names

Table 9: How Useful are Human Resource Information Systems?

Have HRIS	U.S. Companies Number	U.S. Companies %	Non-U.S. Companies Number	Non-U.S. Companies %
Yes	26	23	8	44
No	86	77	10	56
Total	112	100%	18	100%
If "Yes" is it:				
Very Useful?	4	15	1	13
Of some use?	21	81	7	87
Of little use?	1	4	–	–
Total	26	100%	8	100%

Table 10: Extent of Corporate Assistance Provided to Hiring Managers

Level of Help	U.S. Companies Number	U.S. Companies %	Non-U.S. Companies Number	Non-U.S. Companies %
Provide candidates routinely	56	55	11	79
Provide candidates when asked	33	33	–	–
Encourage manager to accept expatriates	12	12	3	21
Total[1]	101	100%	14	100%

[1] Eleven U.S. firms and four non-U.S. firms did not respond.

Leading-Edge Techniques That Build a Global View

When major multinational companies attempt to globalize their managers' experience and perspectives, they take many different paths to attain their objectives. Below is a brief summary of the 10 most promising innovations reported in interviews with human resource directors.

Career Review Groups. All high potential candidates and all managers already serving in an expatriate role are reviewed annually and compared in terms of results, background and promotability. The group performing the review includes the top national and regional general managers, with the international human resource director and the management development director who serve as resource people, advocates and coordinators. Out of this group comes recommendations for transfers, promotions, training, task force memberships, and repatriation assignments.

- *Benefits:* High visibility for employees out of the country; forced comparisons of all candidates; advocates increase the chances of equity; early notice of repatriation.

International Career Counseling. Employees and their families are involved early in formal career planning. Objectives, including the need for international assignments, are agreed upon with eligible candidates. The process involves the selection of rotational assignments and management schools as well.

- *Benefits:* Eases spouse placements; gives firm notice of need for assignment abroad; provides counseling on solutions to problems before they are needed.

Global Committees. To involve many levels and functions, strategic planning committees are formed to determine the worldwide competitive strategies for product lines. Committee members may include strategic planning staff, national marketing directors, product planners, advertising and marketing research people, controllers from the region and others. The committee's mission is to determine the intellectual navigation of the product, while the sales and profit objectives are negotiated between headquarters and the national product group line management (which is still responsible for profits).

- *Benefits:* No long-term family relocations; teamwork benefits; staff involvement in the decision process; visible contributions of team members.

Swap Programs for Fast Trackers. Highly promotable early career managers are encouraged to apply for a program which allows them to spend up to a year in a foreign operation. A similarly qualified manager is sent from the headquarters company to the national affiliate. The swapped executives do not necessarily swap jobs, but both the departments involved generally benefit from company schools, language instruction, orientation projects and some regular work assignments.

- *Benefits:* Cross cultural training and company orientation before a real job assignment; improves visibility of young managers; encourages cooperation among departments.

Controllership Programs. To insure that financial controls and reporting are understood and complied with,

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and career biographies of candidates from other countries. This is as true in the case of TCNs as it is for headquarter country nationals.

- Twenty-nine percent say they will provide data from corporate headquarters on foreign candidates, but only if the hiring manager specifically asks for them.
- Thirteen percent have systems set up to encourage national managers with mid-level openings to consider fast-track foreign employees.

Paying for International Recruitment

Part of the cost of international expatriate recruitment is routinely charged to corporate overheads in most companies. In some others, a division or other operating business unit will take the basic charges for management training, HRIS, or even a share of succession planning costs usually on a pro rata system with other divisions.

Most of the costs of actual expatriate transfers are in travel for interviews, visits for house hunting, and other moving and living allowances for employees and their families. These expenses, along with the costs of language courses and orientation are almost always charged (64 percent) to the hiring organization (see Table 11).

These costs are rising rapidly. They remain one of the major concerns of companies embarking on programs to increase global experience by expatriate assignments. The pressure from this type of expense was one of the stronger motivating forces in convincing

Table 11: Who Pays Recruitment Costs?

Corporate Level	U.S. Companies Number	U.S. Companies %	Non-U.S. Companies Number	Non-U.S. Companies %
Corporate overhead	11	10	1	6
Division (SBU) overhead	23	21	3	16
Partially paid by both	3	3	5	28
Paid by user organization	72	66	9	50
Total	109[1]	100%	18	100%

[1] Three companies did not supply data.

controllers are assigned for three years to every national organization from the home country headquarters. Their mission: to keep an eye on the programs of national management and train national financial people in the worldwide accounting systems used by the company.

- *Benefits:* Early warning system to headquarters; gives experience in selecting and training national managers; provides expertise in the financial, reporting and credit departments of the company.

International Meetings. A large construction company keeps track of hundreds of employee families from around the world. These employees are engaged in project management and have been tapped for advancement. As part of an extensive management development program, large international meetings of senior executives are held in each hemisphere. Invitees discuss prospects, projects and business plans, then spend two days with the high potential managers and their families. While all high potential people cannot attend every year, they average an invitation every three years.

- *Benefits:* Visibility and cross communication; family involvement long before assignment abroad.

Corporate Internships. Individual internships are arranged with well-managed companies in the United States for Japanese managers. Another company lends international expatriates to law firms, trade associations, government regulatory commissions, and other agencies for extensive in-depth work on international business policy issues.

- *Benefits:* Senior management awareness increases rapidly; contacts with foreign competitors and supplier firms; issue orientation on important subjects such as tariff enforcement and the environmental regulatory situation.

Worldwide Hiring. Approaches to worldwide hiring mainly constitute attempts to corner the market on scientists of world-class reputations no matter what their current university or employment affiliation. These big name practitioners are then given roving TCN assignments in the company's laboratories around the globe.

- *Benefits:* Block competitors; instill new ideas in technical and research people; improve company's reputation for top quality science.

Third Country Nationals to School. Large multinationals regularly "seed" the classes of their multilevel formal management development schools with managers from many of their operating countries. In some programs more than half the class are TCN managers.

- *Benefits:* Orientation of foreigners; communication networks established around the globe; policy uniformity assured; home country managers' perspectives changed.

Guaranteed Repatriation. During a time of rapid international expansion, one firm began recruiting managers with the promise of a guaranteed repatriation and specific assignments after the international stint. Since the practice was so well received, it is part of the career planning approach they recently adopted.

- *Benefits:* Helps calm anxiety; sells family on transfer; encourages organization and succession planning.

U.S. companies that grooming national managers was a preferable strategy for international growth in the 1970s. Whether the increase in both line and developmental assignments can be sustained may well depend on the companies' ability to change some long-held compensation and travel policies.

Interviews and Pre-Interview Contacts

As expected, all the responding companies report that they use interviews at the corporate headquarters and the host location to make final judgments about whether to offer an expatriate assignment. Additionally, of course, personnel records, resumes, and performance evaluation documents are provided by the international human resource department to the hiring manager (see Table 12).

Families are interviewed by 32 percent of the sample before an offer is made for an expatriate position. Only 15 companies report they are using psychological tests or other screening devices and only 11 use biographical profiles constructed and validated to help select the most likely candidates to succeed abroad. One company

Table 12: Screening Devices Used to Select Candidates for Expatriate Assignment

	Total Mentions [1]	
Device	Number	Percent
Multiple interviews	96	100
"Exposure" visits or temporary assignments	68	71
Family interviews	31	32
Psychological screening	15	16
Weighted biographical profiles	11	11
Assessment center/panel review	7	7
Performance evaluations	4	4
Career reviews and counseling	2	2
Blind chance and desire	2	2
Seniority	1	1
Selection questionnaire	1	1

[1] Based on 96 companies.

is considering the use of televised interviews with three or four candidates. These interviews can then be viewed by the hiring manager to help decide which individual should be interviewed personally.

A significant and growing number of companies (71 percent) report experimentation with using one or more of their largest international managers' meetings as an opportunity to introduce fast-track managers. In addition, senior managers from all over the world are involved in international task forces with junior executives who are being readied for international posts. The companies' report that this exposure increases the likelihood that an international manager will seek to hire an expatriate whom he has met and with whom he has some familiarity.

A few companies have created innovative programs to fit their special needs. Some of the innovations in this area are:

- Early family commitment to the advisability of several international assignments in the first decade of a career. Spouses are counseled as they might be in some other companies immediately before a specific assignment is offered.
- Mentors who have had past service abroad are provided to younger managers who are faced with deciding about expatriate assignments. In one company, this relationship is extended to the spouses in a manner similar to the officer corps in the military.
- All managerial performance evaluations used in one company are modified to include an evaluation of the employee's ability to work within and around a non-native business culture.

Orientation Programs Continue

All of the companies with more than 10 expatriates serving abroad have established guidelines for family interviews, site visits in advance of assignment, counseling and orientation after arrival. Problems with orienting foreign managers were more often reported by the headquarters group in the home country than they were in the field. A candidate for foreign service must know certain things before making an intelligent decision about accepting an international assignment; some items can safely be deferred until after arrival in the foreign country.

The employee needs to know the nature of the job, responsibilities and authority level, reporting relationships, and the in-company and external relationships that must be maintained. A solid understanding of how the compensation package applies is also important. Both husband and wife should also know the basics of living abroad: housing; work permits and visa regulations; available food, clothing and shopping; schools; churches; health facilities; recreation; social amenities and climate. Finally, the employee should be briefed on the cultural environment and the role the company plays or wants to play in the local society.

The priorities assigned to each of these categories will vary, as will the extent to which knowledge of them will be pursued, depending on a variety of factors. Among these are geographic location; degree of isolation; the extent to which the host country is industrialized; the nature of the candidate's work; and, as always, the time available.

Since orientation of this nature is more of a learning process than a teaching process, the company must determine to what extent it should provide formal orientation as opposed to informal advice and references. The number of expatriates seems to be the factor guiding standardization in most firms. The majority of programs cover almost all of the 15 elements summarized in the box below.

Elements of a Successful Orientation Program*

1. Assure candidate that self-disqualification will not destroy his career if that is the case.
2. Allow enough time for questions.
3. Get the foreign subsidiary to participate in the program design.
4. Assign responsibility at headquarters and in the field.
5. Tailor the specifics of the program to the candidate and his family.
6. Use pictorial as well as written materials.
7. Engage consultants for special needs when in-house resources are inadequate.
8. Include cultural and economic counseling.
9. Provide language instruction to the candidate and family.
10. Make provision for educational and recreational needs.
11. When feasible, offer candidate and spouse a pre-transfer visit to the foreign location.
12. Pay special attention to government processing details.
13. Assign a seasoned expatriate family to help ease the initial adjustment after arrival.
14. Audit the result in each case.
15. Make adjustments at headquarters and in the field as needed.

* Suggested by 33 HR executives contributing to a previous Conference Board study, *Selecting and Orienting Staff for Service Overseas.*

Determining Scale of Compensation

Because of high family relocation and housing costs, some companies are only offering hardship differentials when the assignment is in difficult climates or outpost-type facilities. City locations in almost any country do not qualify. On assignments of known duration, a few companies have purchased apartments and the manager is required to use these living quarters. One Japanese company arranges dormitory-style quarters for its younger managers abroad for training assignments.

One major saving being widely pursued by companies is converting short foreign assignments into extended business trips. This prohibits dependent relocation and all expenses are treated as normal travel expense. In response to complaints, some firms have agreed to pay for spousal visits during these development assignments.

Certainly in today's average development assignment—and for many routine managerial assignments in industrialized countries—extra compensation is not needed to make the assignment acceptable to fast-track managers. In many foreign countries the assignments have more occupational and social status than they do in the home country, and the lifestyle is better than it would be at home. In addition, since many firms now include such assignments as part of regular career planning, expatriate offers cause less disruption of the employee's family life than they previously might have. However, repatriation is also more difficult when various kinds of premium pay are subtracted from the employee's usual compensation. This difficulty will be increasingly pronounced if the return is to a lateral assignment rather than a full-fledged promotion.

Several HR people raised the argument that the successful completion of the international assignment makes the employee more valuable in the job market upon return. They see no reason to continue a pay concept based on the governmental foreign service when such a model is no longer the corporate model for expatriate assignment.

Trends in Expatriate Recruiting

Today's international human resource managers feel that they are beginning to see results from the programs they have in place for developing a pool of internationally experienced people. Various factors have influenced the direction and success of this effort. Respondents commented on major trends which are of increasing concern to multinationals trying to develop a globally aware cadre (see Table 13).

More Assignments for Scientists Abroad

Although few companies now depend upon expatriates to manage R&D activities abroad, 23 percent of 126 companies forecast that short development assignments for scientists and engineers are likely in the future. These assignments would enable technical people to work for three months to a year with project teams and experts at facilities outside of the home country. At the same time, these assignments are cheaper because dependents are not relocated.

Several respondents envision a rapid changeover to global sourcing and hiring in many scientific disciplines. The race is already on for top names.

Earlier Assignment Abroad

Another significant trend is moving the first international assignment earlier in the career pattern. Employers mentioned several benefits including first assignments are often developmental and family concerns are not as great at this stage.

Some rapidly expanding companies send marketing managers abroad as soon as they show promise in the headquarters or regional offices. Since today's adjustments must be made quickly, there are simply not enough experienced marketing and manufacturing managers to allow the company to attain "critical mass" in time to meet the competition in world market.

More Foreign Nationals

Out of those surveyed, 17 percent of the companies also forecast that more foreign nationals will perform work assignments at the corporate center in the home country. This is especially true for European-based companies which plan to consolidate headquarter operations in only one country. In addition, many U.S. senior managers are pressing for a larger voice in the management

Table 13: Future Trends in Expatriate Assignments

	Most Likely		*Second Most Likely*		*Third Most Likely*	
Trend	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
Short assignments for scientists and engineers	29	23	14	11	13	12
Assignment at earlier career stages	24	19	18	14	13	12
More incoming foreign nationals	21	17	30	23	17	16
More assignments to joint ventures	19	15	18	14	19	18
Short assignments for senior executives	16	13	29	22	15	14
Hire CEO with international experience	14	11	8	6	10	9
More female expatriates	3	2	13	10	21	19
Total[1]	126	100%	130	100%	108	100%

[1] Some companies mentioned more than one trend.

of European multinationals where the U.S. subsidiary is contributing the lion's share of gross sales. A third group of foreign nationals are the MBAs and engineers who are the subject of a feeding frenzy by recruiters from many technically oriented U.S. multinationals.

Joint Ventures Increase

For both large and small firms, international joint ventures are either the best or, in some cases, the only way to enter a foreign market. The recruiters forecast a spurt of upper-middle level executive transfers to many of these assignments. They point to the fact that these new companies provide high-level functional executive assignments in human resources, finance, advertising, distribution, packaging and other specialties. Many of these positions in existing national affiliates are customarily held by national managers.

Globalizing Senior Executives and CEOs

More than 10 percent of the companies are involved in creating short foreign assignments for senior executives to improve their knowledge and appreciation of international business. As in the case of scientists, brief task force assignments stimulate new lines of thinking, bring new contacts, and introduce foreign operations to the experience of key headquarter executives.

For over 10 percent of the companies, installing an internationally experienced chief executive is important. About one-quarter of the firms anticipate this as one of the three most likely futures in their companies. Since 44 percent of the respondents already had CEOs with significant international business experience, this represents almost 50 percent of the remaining companies. In interviews, HR executives always had more reservations about a company's strategy to become a world-class competitor when the CEO had no real experience managing these international operations.

More Female Expatriates

For another 31 percent, an increase in female appointments to expatriate jobs also tops the list. This prediction is more common among service firms and banks than among manufacturers; however, this may reflect the greater number of younger female managers in service businesses. Even 5 of the 18 internationally based multinationals recognize the trend among their top three predictions.

Ethnic Barriers

Some 14 percent of the U.S. companies in the survey operate in nations where certain nationalities or ethnic groups are not accepted culturally or, in some cases, legally as company representatives. At a time when companies are using more TCNs as managerial transfers, these restrictions can hamper effectiveness. While discrimination against many groups is changing slowly, firms do not want to expose expatriates and their families to hostile social conditions.

Twenty-three companies criticize their own internal policies as setting artificial limits on expatriate assignments. For example, the "glass ceiling" in Japanese-owned multinationals reserves large numbers of general management positions for Japanese citizens in Japan and abroad. The attitude of Japanese management is that outsiders are liable to make too many mistakes in coming to agreement with other senior managers in their typical consensus-based management system.

For some companies the problem of reserving positions for nationals has little to do with ethnic prejudice. These companies have been successful in training and promoting national managers in each country in which they operate. The headquarters human resource executives now claim that it is difficult to convince these managers even to consider expatriate managers transferring into their organizations.

Long-Term Outlook

Table 14 summarizes some of the problems that HR people see ahead as they build an internationally aware organization. While many issues were mentioned, including family values, dual career issues, problems of repatriation, and corporate image worldwide, executives concentrated on downsizing, rising costs, new trade agreements forming in the world, and difficulties in education and college recruiting.

Downsizing and Expatriate Recruiting

Since many of the companies are involved in rapid expansion in worldwide business, few were seriously bothered by the waves of management layoffs, early retirements and downsizings. However, for those affected, change is still echoing through their programs.

Smaller Pool, Bigger Problems

The most obvious effect of management cutbacks is the smaller pool of managers from which expatriates can be recruited inside the company. Three effects were noted: Some expatriates were actually terminated; some managers who might have been recruited to foreign jobs were laid off; and some managers sensed the insecurity and left the company. Other respondents admit that layoffs elsewhere in the firm had a chilling effect on their ability to paint a healthy career picture for those who were considering expatriate assignments (see Table 15).

For the most part, the seniority of the separated executives was so high that they would not have been involved in many expatriate searches. The HR executives do agree that any instability, whether caused by contraction or expansion of the work force, will have an unsettling effect on the process of recruiting and selecting managers for international work.

Need to Focus on International Vision

During the cost cutting and recession planning, a fair number of companies lost their desire to become major world-class competitors. Human resource directors complain that the strategy changed overnight in some situations. Development assignments were canceled as too expensive. Plans to establish new offices were put on hold. Repatriating executives were terminated when they arrived home.

For all these companies, the recession and delayering was an organizational distraction. The company man-

Table 14: Anticipated Problems in Recruiting Employees for International Assignment

	Total Mentions [1]	
Problem	*Number*	*Percent*
Pool has been downsized	14	18
Costs are increasing	10	13
Family pressures increasing	9	11
No formal international management development	8	10
Repatriation too difficult	8	10
Dual career issues	8	10
Shortage of technical employees	6	8
Competition will increase	6	8
Company image problems	5	6
Too few jobs open for expatriates	5	6

[1] Based on 105 responses, of which 26 companies reported foreseeing no problems.

Table 15: Have Work Force Reductions Interfered With International Assignments?

	U.S. Companies		*Non-U.S. Companies*	
	Number	*%*	*Number*	*%*
Yes	89	21	2	11
No	23	79	16	89
Total	112	100%	18	100%

agements that stayed the course all found it necessary to continue to restate their international priorities as they guided the company out of recession.

When Loyalty Goes

The major loss still felt in the international business community is the diminished loyalty of employees to the company. Many managers feel that executives wary of expatriate assignments illustrate decreased loyalty and team dedication, particularly in U.S. firms. Now, they say, every career expatriate assignment has to be sold to the candidate as well as his or her family. Whenever a company has poor experiences with repatriates, current recruiting is made much more difficult.

On the other hand, some respondents claimed recruiting was actually made easier by the job turmoil back home. They refer to gratitude expressed when foreign opportunities come up when the situation back home is unstable. This was also true in cases where a second assignment abroad, rather than repatriation, was offered.

Lateral Placement Acceptable

With fewer management layers in the hierarchy, job content begins to outweigh job status, say many of the HR executives. That equates to an added benefit when employees are weighing the desirability of an international assignment. Many of the overseas assignments which are primarily for development have little intrinsic job status in the national organization. To a local national the duties would not be interesting; however, to an expatriate manager the position becomes more exciting because it is international. Whether employees will find that such positions and experiences really add to their corporate skills and value remains to be seen.

Do More With Less

The motto of the late 1980s—do more with less—caught the human resource departments off guard. They were asked to plan and cope with large layoffs and reorganizations. At the same time, they were to increase their international screening and development. In fact, many of the respondents lost their management development officer in the cost cutting. Some of the respondents cite the lack of international HR staff as the reason for ineffective HRIS, which computerize job specifications and candidate qualifications. Others flatly say they see no way to revamp extensive management development programs to include material on international business without hiring new staff.

Rising Expatriate Costs

Trying harder to speed up the globalization of U.S. managers is not only difficult, it is expensive. While only 38 percent of foreign-based multinationals cited the high costs of sending expatriates abroad, 45 percent of the U.S. companies winced at the bill. Whether this difference reflects real cost differences or merely past histories is difficult to say.

Many companies are revisiting their cost experience in sending expatriate families abroad and are looking for savings by adjusting their support techniques:

- More temporary and development assignments are being used. They fall under business travel expense policies.
- Foreign service pay premiums may no longer be routinely paid unless there is real hardship or difficulty in recruiting.
- Companies are buying housing abroad and requiring rotational assignment employees to use it.

Whether the costs of sending expatriates and their families abroad seem out of line, most of the respondents feel there are few real alternatives if they are to attain the basic thrust of their international growth strategies.

Effects of New Trading Blocs

Among the survey executives and those interviewed, there was a wide divergence of opinion on the potential effects new trade groupings would have on their staffing programs. The new Common Market, the emerging markets in Central Europe and the Canadian/U.S./Mexican trade agreements are viewed very differently by experienced European and U.S. executives.

The European and North American trade agreements now unfolding will have a major impact on the selection and assignment of expatriates, say 61 percent of the HR executives in non-U.S.-based multinationals. This contrasts with only 35 percent of the HR respondents in U.S.-based multinationals.

The European and the Japanese firms were generally more aware of the Common Market progress than were the U.S. firms. This was true even though the U.S. firms have extensive European operations. Throughout Europe there are industry planning groups with months and years of experience behind them, working on the effects of the new rules on expatriate working permits and family travel within Europe. Most are happy with the picture that is emerging:

- Consolidations of headquarters will be possible for some of the firms. This will involve regrouping senior- and middle-level managers at a continental or regional level. The HR directors are expecting to deal with much more language instruction and with delayering operations after functions are consolidated.

- The respondents see the possibility of much more transnational business from a headquarters location and less duplication of customer contacts.
- They predict a sharp rise in intra-European transfers and the use of many more TCNs.
- They see an easing of spousal working permits which will make reassignment much more palatable.

On the negative side, the Europeans are gearing up to defend themselves against "head hunting," but they feel that the larger corporate talent pools available on an EC-wide basis will be a long-term factor which will ease competition.

Managers in U.S. companies recognize that placement of families in Europe will be easier. Some of them are following their European counterparts and creating a cadre of international managers in functions such as distribution, human resources, and EC regulatory compliance. These employees will become regional specialists. Whether this tactic will succeed or merely breed regional barriers to global business communication, depends on industry and corporate practice developments.

Central Europe a Concern

Several surprising developments are occurring concerning the business expansion in eastern Germany. One of the HR managers explained that in 14 months, his company had gone from 0 workers to over 20,000 in former East German territory. Other German firms have also rapidly shifted priorities in the last two years to concentrate on building a unified Germany.

Companies in the United States are generally taking a wait-and-see attitude toward staffing operations in Central Europe. However, as governments are formed and aid and trade policies finalized, European and Japanese managers say they are ready to assign as many expatriates as needed to build an early presence in these emerging markets.

Mexico Will Make a Difference

Recruiting expatriates for Mexican expansion is seen by the Japanese and some U.S. firms as a top priority in the next three years. Their planning is complicated, however, by the fact that many corporations treat the United States, and sometimes Canada, as one market, while Mexico has been placed in a Latin American division—presumably on the basis of language. A number of companies are now scurrying to structure a North American region which will include business in the three trading countries. Several Japanese firms are planning major affiliates in the southwest to manage increased Mexican business.

Depending on the industry, U.S. firms are beginning to look at Mexico as either a new market or as a competitor. But only a few see Mexico as a gateway for dealing with the North American trading group on favorable cost terms (much as Spain is viewed in the European Community).

Effects of Changing Education Practices

Human resource managers are warning U.S. companies that a combination of demographics, cultural stereotyping, and the declining effectiveness of U.S. schools will make technical and engineering staffing in the United States much more difficult over the next five years. As a result, companies are beginning to turn to TCNs for long-term assignments in U.S. laboratories. In addition, they are recruiting foreign students from top engineering schools. "So many of our technical people are foreign citizens," says one manager, "that we have regular seminars on multicultural management for our U.S. people."

In planning for management development, many companies are reluctantly setting up curricula to remedy the educational deficit in geography, international politics, economic systems, and foreign language study, which they complain have been characteristic shortcomings of U.S. schools at every level for at least 15 years.

Global Focus for College Recruiting

In addition to the pharmaceutical companies which are intent on competing for top scientists everywhere in the world, a group of multinationals—many European—are beginning transnational MBA recruiting. Several human resource directors lament the fact that until recently their company had not recruited centrally or regionally through the best national business schools.

The European Common Market's loosening of work permits and other restraints are likely to allow recruiting from French, English, German and Italian top business schools. Rather than a conscious tactic for broadening their nationality base, however, this transnational recruiting seems to be a way to add "top schools" to the list for prime MBAs and to create a world market for MBA degree holders interested in international business.

Case Study One

Mitsui & Co. USA, Inc.

Mitsui & Co. USA is a major subsidiary company of the international trading giant Mitsui & Co., Ltd., of Tokyo, Japan. The company as a whole has gross revenues exceeding $147 billion fiscal year 1991 and a worldwide work force of approximately 12,000.

During the 1980s, Mitsui USA's president and CEO along with the senior vice president for human resources of the U.S. company became aware that Mitsui USA should begin a Localization program, which would be designed to improve the recruitment, training and development, and international bi-cultural appreciation of U.S. nationals both employed and hired by the company in both exempt and nonexempt positions. In 1989, a completely new professional human resource staff was hired, led by an experienced general manager who was a U.S. national.

Several key programs were put in place to help internationalize Japanese rotational managers working in the United States. Other development opportunities were created for U.S. nationals who were to become more experienced in managing and understanding the company's management and business systems.

Career Development Mentor Program

This is a five-to-eight year program designed to prepare talented individuals to eventually assume management or key responsibilities in either business units or subsidiary operations. The program provides rotational training assignments in business and support areas; an international assignment in Mitsui Tokyo; and specialized work in a business function. Career guidance is provided through a dual mentorship of a senior vice president and the general manager of human resources department.

The program began with college grads, but is rapidly adding selected employees and mid-career professionals and managers with 10 to 15 years of company experience. The recruitment activity was directed toward several top business schools such as: Harvard; Columbia; Cornell; American Graduate School of Business; New York University; Texas A&M; and Stanford.

Training and Development Revamped

The nature and amount of training and development that should be given to U.S. managers was one of the most perplexing questions for managers in Mitsui Japan and the U.S. company.

In March of 1989, Mitsui USA's Training and Development function was asked to create an "International Development Program" (IDP) for Mitsui USA and other Mitsui affiliates worldwide. They produced a formalized step-by-step development program for the immersion of a manager in Mitsui's Japanese operations. The program is available to managers with three years of company service who have consistently strong performance ratings, high energy, a desire for international development generally and for assignment in Japan early in their careers. Three variations on the program were offered:

International Development Program I (IDP I) is a six-month temporary assignment in either Tokyo or Osaka. Candidates must have some Japanese language and cultural skills and strong English skills.

Approximately three months are spent on intensive Japanese language skill development. A second three-month period is spent in a host department where the focus is on developing an understanding of the Japanese people and culture and on an orientation to Mitsui's business, management systems, organization structure, and corporate culture. About six participants from all Mitsui affiliates are accommodated in every six-month session. Dependents are not relocated and participants live in a Mitsui employee dormitory.

International Development Program II (IDP II) is a year-long temporary development assignment in Tokyo or Osaka. Another three-month course in Japanese precedes the on-the-job training assignment of nine months in a host department.

The U.S. company selects the department in the headquarters company; if that department accepts the assignee, his training focuses on strengthening knowledge and skills in Japanese business and trading activities. Again, the assignment is considered a yearlong business trip and dependents are not relocated.

International Management Program (IMP) is a one-to-three year assignment in Japan, where the entire first year is spent in on-the-job training status in the headquarters company.

Selection of participants is made by the candidate's general manager and takes into consideration the business strategies of the business groups and regions as well as human resource development needs and plans. The host department for the international work assignment of two years is selected jointly by the U.S. company and Mitsui Tokyo's personnel division.

IMP focuses on the development of candidates for higher management and professional positions in Mitsui USA or for international mobilization throughout Mitsui's global network of operations. Relocation benefits are offered to the spouse and dependents during the Japanese assignment. The company uses a step-by-step approach to overcome the rather severe cultural and linguistic barriers which U.S. managers encounter when they are involved with the headquarters in Japan.

Mitsui Japan has similar programs for orientation and career development of Japanese managers by providing rotational assignments to major affiliates around the world. There are over 300 rotational employees from Japan working in three-to-five year assignments in the U.S. company or its affiliates.

Rotational Employee Training

In Japan, Mitsui headquarters wanted to expand globalization by working with its U.S. affiliate to establish the development program called USA Trainee Program. This was designed to meet the needs of young Japanese trainees who were sent to the U.S. as "International Practical Trainees."

The program is extraordinary in that it involves trainees in education at top business schools, formal language study, and cross-company internships arranged at a few well-managed and quality-oriented U.S. corporations. Below is a complete description of this program.

USA Trainee Program

Objective

For the purpose of expanding the company's staff of versatile international business professionals and furthering the company's global localization strategy, Mitsui & Co., Ltd. in Japan needs to establish a comprehensive development program based in the United States.

Special emphasis is on English language and U.S. culture and customs, graduate level business and economic courses, practical experience through corporate internships and community volunteer activities.

Each employee must develop a level of business acumen and personal rapport and confidence with their fellow U.S. employees and with the business community at large.

Background

The former USA Trainee Program is being revived and enhanced. The major change in the 1990 program is the addition of corporate internships with major U.S. international companies. This has been suggested in order that our Japan-based trainees may experience firsthand, a different company culture, management style, and "corporate citizenship" program. The hope is that the trainee who experienced the internship will one day serve as an interface in building the client's and Mitsui's businesses.

Participating Companies

Selection: Progressive, well-managed U.S. corporations who are willing to work with Mitsui & Co. in training Japan-based employees through on-the-job internships and involvement in community volunteer activities.

Benefits: For the corporate partners who participate with Mitsui, tailored reciprocal development activities can be arranged, including short-term trips to Mitsui's entrepreneurial businesses or staff departments. Upon completion of program and eventual assignment to Mitsui & Co. headquarters, USA Trainee Program attendee will hopefully be assigned business development responsibilities with this same U.S. corporation.

Participating Universities

Selection: Outstanding universities located throughout the U.S., who can provide a tailored program of study covering the political and economic environments, industrial relations/human relations, and business and legal areas that will help each employee develop a level of business acumen and personal rapport and confidence with their fellow students, coworkers and the community at large.

Benefits: A few well known and highly respected universities located in a variety of locations throughout the U.S. will have an opportunity to work closely with Mitsui & Co. in piloting some innovative approaches in developing professionals and managers with a truly global perspective.

Participant Profile

Employees who are recent university graduates with three-to-five years work experience with Mitsui & Co.; strong English language abilities (minimum 550 on the

Test of English as a Foreign Language [TOEFL], desired 620 TOEFL); an openness to new cultures, customs, practices and values; and an ability to adjust to new living and working environments are among the requirements for the USA Trainee Program.

Mitsui & Co. USA will provide assistance to Mitsui Japan in the selection and assessment of candidates for this program, and will serve as interface between participating companies and universities.

Mitsui's corporate partners, who may desire a reciprocal arrangement, may decide to send employees at different levels of experience.

Visa Requirements

For a J-1 Business Trainee visa, an individual must be engaged in on-the-job training. Currently, there is an 18-month limitation on the practical training aspect of the individual's stay, which more than meets the needs of the program.

Length of Program

Approximately two years: includes three months of intensive language and culture training, nine months of on-campus studies, and up to twelve months for corporate internship(s).

Program Overview

Phase I — Summer 1991. Ten-week intensive study in language and culture at the Boulder Economics Institute.

Phase II — Fall 1991. University studies, credited, graduate level courses, three major universities. Community involvement, volunteer activities.

Phase III — Summer 1992. Three months to one year on-the-job training; internship at major U.S. corporations. Community involvement, volunteer activities.

Program and Participant Assessment

A quarterly review process will track each participant's development. A travel budget will be established to cover the program participant's visits to Mitsui & Co. USA headquarters and field locations (as determined by the employee's career plan), and to the participating U.S. corporations prior to the effective start of the internship.

Case Study Two

Pharmaceutical Company

Management is committed to making human resource planning happen around the world. The commitment to planning performance, careers and continuity applies to international managers whether they are coming to U.S. assignments, or Americans going to jobs at the world headquarters city—or to other international locations. The company spends considerable thought and energy on the development of internationally experienced managers.

The U.S. company contributes about 25 percent of the gross of the parent company and it has over 20,000 employees in the United States and on international assignments. It views its HR challenges for the 1990s as:

- evolving a North American regional headquarters organization.
- building its more than two dozen business groups rapidly.
- providing policy executives and internationally experienced managers to improve the continuity of worldwide leadership in global markets.

Planning Process

The human resource planning process has four segments which are reviewed at different times of the year:

- objective setting
- performance review
- personal growth planning
- continuity planning

The objectives of the process are clear:

1. The company worldwide wants to establish a common set of values among its employees.

2. The process should improve the probability of having the right people in the right jobs at the right time.

3. By full participation in the planning process, a manager can manage his or her own career and achieve his or her potential.

It is in the area of personal growth planning that the company's international cadre is distinguished.

International Commitment

The company makes it clear to promotable managers that if they wish to advance in a global company, they should plan international expatriate assignments. Each manager is encouraged to look ahead with his or her spouse to think about foreign assignments of two types:

- One-to-four year operating assignments with P&L responsibility.
- One-to-eleven month temporary assignments for development purposes.

The human resource department will assist the employee and his manager to outline the development steps needed to make the resulting career plan a reality.

During the continuity planning by business units, and at the time of the corporate review, managers who could benefit from an international assignment are identified. The company considers females and minority candidates for any such promotion or transfer.

Training in leadership, team participation, and the coaching required in a global company is available to all managers. Considerable pressure is applied to encourage all international managers to learn the country's language.

The company sees the following future trends as requiring new efforts in recruiting, selecting, and transferring employees:

More Experience for Senior Executives

If U.S. senior executives are to assume key positions in guiding the company worldwide, they must be given expatriate assignments.

Earlier Assignments

Because of rapid growth in the company's international business, both developmental and operating assignments abroad must occur earlier in the manager's career. This will put stress on the basic management skills training process and on the assessment and performance review programs. The company formalized all of these processes in an effort to meet this constraint.

North American Readiness

Many of the newest assignments will be in Mexico and Canada as the U.S. company becomes the center for the new North American region. The readiness of managers, including Spanish language preparation, is appraised and then entered in a human resource database.

In addition, managers from those two country operations will probably be sent to U.S. headquarters for various training assignments. This will require more time and effort spent in multi-cultural appreciation courses and business system retraining.

Technology Shortage

Complicating all levels of international recruiting and assignment is the fact that many of the world's top chemical scientists are in China, Pakistan, India, Sweden and other countries.

Already a global competition exists among chemical and pharmaceutical firms to hire and intelligently use the talents of these outstanding people. In almost every case, expatriate assignments are required to be structured for these people in an increasingly complicated international visa and work permit atmosphere in the U.S. as well as European countries.

Timing Is Biggest Challenge

In the mosaic of career planning in the U.S., overlaid with the new North American and worldwide requirements, timing career moves and finding time to be concerned about re-entry are the most difficult challenges, say the recruiters at the company.

Computer support, global review committees, and the greater use of shorter, temporary moves are the answers to the pressures stemming from the rapid changes in the new business organization.

Case Study Three

3M Company

A company with a heartland headquarters, a manufacturing background, and a reputation for U.S. "can do" innovations, may not seem to be a model of the global company, but 3M Company manages very well as a world-class competitor. It's a good example of a thoroughly experienced international company that is still struggling with the problem of globalizing its management.

The company has a worldwide presence with significant operations in 56 countries. Following the preferred practice, 3M has developed and staffed strong national organizations. It has almost 200 U.S. expatriates and 58 foreign nationals working outside their home countries.

Approximately half of the company's sales come from its international operations, but its senior organization is highly centralized. For example, almost all of the company's vice presidents are at company headquarters in St. Paul, Minnesota. However, the company is acutely aware of what is necessary to assure its continued growth into a globally oriented company.

Leaders With International Background

The CEO and three of four executive vice presidents have had significant operating experience abroad. More important is the fact that the need for international operating responsibilities in the background of executives has been a guiding principle in developing the leadership in the 22 strategic business units.

Systems Support Globalization

Because of 3M's extensive operations outside the U.S., managers are used to working with global human resource systems. The company includes international qualifications in its comprehensive human resource guidelines and will often provide a hiring manager with in-house candidates from more than one country.

Information system costs are part of corporate overhead, but the receiving organization pays the direct costs of hiring, relocation, and in-unit orientation and training.

Management Development by Consensus

One difference between 3M and many firms is the amount of review high potential candidates receive from management throughout the organization. This comprehensive approach to HR planning is called the "Health of the Organization Review." It is summarized in company documents as follows:

Introduction

"The long-term growth and success of the Company requires focused attention on the identification and development of management resources. Maintaining management continuity requires anticipation and planning for organizational change and executive replacement. Increasingly, management quality and depth is regarded as a critical business issue and a source of competitive advantage.

"The Health of the Organization Review conducted annually with the Executive Resources Committee supports the strategic and operating objectives of our businesses. Each review identifies and manages the problems and opportunities related to management performance, replacement and development through the participation of the Chief Executive Officer and other members of the Executive Resources Committee."

Purpose

"Each line/staff Health of the Organization Review is designed to provide an overall assessment of executive resource planning for the unit and the depth of talent available. It reflects the depth of management strength and provides a medium for describing the quality and performance of executives, designating high potential individuals and reviewing critical issues and priorities.

"The Health of Organization Review assures that:

- The nature and impact of current and future business conditions on key management requirements are identified and examined.

- Plans and replacements for key management positions are reviewed from a corporate perspective.
- Management talent of the highest quality is available to meet future needs and that candidates are considered on a company-wide basis.
- Employees with high potential are identified and provided with opportunities for development and advancement to realize their potential."

Preparation

"The Health of the Organization Review, as an extension of the annual Human Resources Review process, uses the Performance Appraisal & Development forms and Replacement Planning Tables as input documents submitted to Executive Resources following Human Resource Review consensus meetings.

"Responsibility for the origination of meeting material is shared by the presenting executive and the assigned Human Resources Director.

Meeting Issues

"The issues to be discussed include the following:

- overview presentation—key issues affecting management resource requirements.
- executive conference member's performance and replacement planning
- replacement planning for director level positions
- performance/promotability assessments
- high potential identification
- management effectiveness progress
- affirmative action progress
- international assignments
- key management retirements
- risk taking characteristics of the organization and key management

"The Executive Resources Committee at each significant organization level must come up with substantial consensus concerning which employees around the world should be labeled as "High Potential" and which should be rated high on the "Degree of Willingness To Take and Sponsor Risks."

International Assignments

"To this review process is added specific recommendations, by name, from the international human resource director.

"Each candidate is coded according to basic personal data and management effectiveness. All employees currently on assignment abroad are re-evaluated and a list of those recommended for international assignment becomes the basic pool from which expatriates will be drawn."

Future Trends

Because of this comprehensive approach, 3M has few problems in finding candidates—including females—for its assignments. However, it sees growth as a reason for concern and is pushing initial international assignments earlier in the managers' careers. Technical assignments for scientists and engineers will also be significantly increased as the company attempts to put a global face on innovation and product development.

Extensive management reserves, already identified through the process described above, have compensated in the succession plan for the retirement of many managers and the "delayering" that has cut middle management numbers in some organizations.

Related Conference Board Publications

Organization Designs for the 1990s, Report No. 927, 1989

Building Global Teamwork for Growth and Survival, RB-228, 1989

Developing New Leadership in a Multinational Environment, Report No. 874, 1985

Trends in Corporate Education & Training, Report No. 819, 1985

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The Conference Board

Report Number 1000

North American Outlook

The near-term prospects for North America show:

- *United States and Canada are highly competitive, low-margin business environments.*
- *Mexico is key to new market growth.*
- *Mexico is also a gateway to Central and South America.*
- *NAFTA implementation is unlikely until late 1993.*

The Conference Board of Canada

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About The Conference Board

Founded in 1916, The Conference Board's twofold purpose is to improve the business enterprise system and to enhance the contribution of business to society.

To accomplish this, The Conference Board strives to be the leading global business membership organization that enables senior executives from all industries to explore and exchange ideas of impact on business policy and practices. To support this activity, The Conference Board provides a variety of forums and a professionally managed research program that identifies and reports objectively on key areas of changing management concern, opportunity and action.

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The Conference Board of Canada is an independent, nonprofit organization whose mission is to be the leading private applied research institution dedicated to enhancing the performance of Canadian organizations within the global economy. The Conference Board of Canada's studies of management policies and practices, public issues, the economic environment, and international business produce a continuing flow of timely and practical information to assist leaders of Canadian business, government, labor and other institutions in arriving at sound decisions.

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The Centro de Estudios Economicos del Sector Privado, A.C., is a Mexican private sector institution devoted to economic analysis and research. It is also the economic research arm of the Consejo Co-ordinador Empresarial (CCE), the organization that coordinates the main private sector organizations in Mexico. Established in 1963, the Centre is a nonprofit institution, sponsored by the main sector organizations, as well as by almost 500 private companies.

The Centre's mission is to provide objective and timely economic policy analysis to the CCE, to other business organizations, and to its corporate sponsors, based on a free-market philosophy, in order to influence the design and orientation of economic policy in Mexico; to provide economic advice to businesses; and to orient public opinion.

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North American Outlook

by Gail D. Fosler

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About the Author

Gail D. Fosler is Vice President and Chief Economist of The Conference Board, Inc. She was the project director for *North America: The New Competitive Space*, the first in a series of research reports directing business thinking to the dynamic marketing opportunities developing between the United States, Canada and Mexico. She recently authored an article in *Comercio Internacional Banamex*, Mexico's leading business magazine, which focused on the commercial issues and regional changes resulting from ongoing NAFTA negotiations.

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From the Presidents

The accelerating pace of change in Mexico and the current North American free trade negotiations have called attention to emerging business opportunities in North America as distinct from the United States. The gradual elimination of barriers to trade and investment creates a region-wide market perspective and options for combining the labor and technological advantages of the United States, Canada and Mexico that may benefit businesses operating in North America, relative to other global competitors. Accordingly, businesses will need new approaches to analyze economic developments in the region, rather than maintaining a separate perspective for each country.

The Conference Board, Inc., The Conference Board of Canada, and Centro de Estudios Economicos del Sector Privado, A.C. (CEESP) are, therefore, pleased to present the first report in a series on the North American economic and business outlook. This is the first cooperative effort by the three organizations and follows a joint project last year between The Conference Board, Inc. and The Conference Board of Canada titled, *North America: The New Competitive Space*, which looked at the genesis and the prospects for a North American free trade agreement. This current report examines the economic prospects in North America relative to other global regions as well as in the United States, Canada and Mexico, individually. It also addresses the prospects for a North American free trade agreement and the implications of the changing trade and investment environment for business.

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Executive Summary

North America is emerging on the world scene as an economic region in its own right. Both the prospect of a free trade agreement and Mexico's remarkable economic progress in recent years have drawn attention to opportunities available in the United States, Canada and Mexico. Together, these countries make up a market of 360 million people with a total gross domestic product (GDP) of $6 trillion. Of course, the United States dominates the region because of its size, and for most of the 1980s U.S.- Canadian trade fueled North American trade. Now, Mexico is the focus of increasing trade and investment because of its dynamism and its potential for extraordinary economic gains during the 1990s.

The United States accounts for roughly 87 percent of North American output with Canada and Mexico comprising about 9 and 4 percent, respectively. Thus, in the short term, the North American outlook is dominated by economic weakness in the United States and Canada rather than the stronger growth in Mexico.

Overall, North America is expected to grow just 1.8 percent in 1992 with only a modest improvement expected thereafter. The differences among the countries, however, are substantial. The economies in both the United States and Canada are struggling to recover from last year's recession with growth this year expected to be only about 2 percent or less. Mexico, on the other hand, is driven by domestic policies of reform and market opening. Though relatively untouched by the recession and stagnation of its northern neighbors, Mexico's growth would have been much higher than the 4 percent now expected were Canada and, in particular, the United States in a full-scale recovery.

Mexico Is Emerging as a Significant Market

The overall growth rate for the Mexican economy understates its potential as an important world market. Total domestic demand in Mexico is rising more rapidly than output—much of which will be satisfied by imports. This means that although small in terms of relative GDP, Mexico can actually constitute as much as 15 to 20 percent of the total domestic demand growth in North America as a whole.

Capital goods is the fastest growing sector in Mexico. Mexico's business investment is projected to grow by about 14 percent this year and makes up close to 20 percent of the Mexican economy. Moreover, the absolute growth in the Mexican market can actually exceed the United States during periods of depressed growth. Mexico will account for virtually all of the net growth in business spending in North America this year because Canadian investment is weak and investment in the U.S. is likely to decline for a second year in a row. Even during a normal U.S. business expansion, the pace and level of Mexican investment can equal one-quarter to one-third of the total North American capital goods market.

Most Industrial Countries Stagnant

The slow growth in the United States and Canada is symptomatic of disappointing economic performance in other industrialized countries. The European Community as a whole is growing well below its 1980s trend; and Japan, and many of the countries in Europe, are near or in recession.

Mexico, by contrast, is more reflective of the emerging prosperity in the rapidly industrializing countries—the best examples of which are found in the Asian market economies in central and southeast Asia. The domestic markets in virtually all of these countries are growing three, four, and in some cases, five times faster than Europe or Japan. Indeed, although these markets are often much smaller in absolute terms than industrialized country markets, they will provide a large share of the market growth worldwide over the next few years. The rapid growth of private investment in Mexico is much more like that of the industrializing countries, which were so successful during the 1980s, than that of the United States or Canada.

Free Trade Important to Trade and Capital Markets

A North American free trade agreement (NAFTA) is not likely to be finalized during the current Congress even though the U.S. negotiators have committed to try to submit a text to Congress this year. The Administration's existing "fast-track" authority expires on May 31, 1993. The "fast-track" process requires that the Administration notify Congress 90 days in advance of submission of the text of the agreement and provides Congress 90 "legislative" days in which to act. Under Congressional timetables, this could extend over several months. As a result, a free trade agreement is not likely to be approved before next spring at the earliest.

The absence of a free trade agreement does not affect the near-term outlook. Much of the increase in trade and investment among the United States, Canada and Mexico is the result of the tariff reduction, deregulation, and privatization that has already occurred under the Mexican Economic Stabilization Program rather than the prospect of still lower tariff and nontariff barriers under a North American free trade agreement. Nonetheless, the failure of a free trade pact would call into question the commitment of the three countries to free trade and market liberalization. For a region with an increasing foreign trade deficit that needs foreign capital to finance growing public and private borrowing requirements, the failure to push free trade forward could sharply curtail capital flows that are already dangerously weak in Canada and the United States.

Mexico Is the Gateway to Latin America

Trade among the United States, Canada and Mexico has more than doubled during the 1980s. The United States is overwhelmingly Mexico's largest trading partner accounting for two-thirds of total Mexican trade. More important from the vantage point of the United States is the fact that virtually all the increased trade between the two countries is due to higher U.S. exports to Mexico, rather than Mexican exports to the United States. United States exports to Mexico have increased at an average annual rate of 16 percent per year from 1985 through 1991; and these exports include a wide range of manufactured products such as home appliances, chemicals, electronic equipment (especially personal computers) and auto-related items.

Although Latin America currently accounts for only 7 percent of all Mexican exports, Mexican trade with Latin America is growing rapidly. For example, one-fourth of all Mexican produced autos is shipped to markets in Latin America. Moreover, last September, Mexico signed a free trade agreement with Chile which became effective January 1992. It is very likely that by year-end Mexico will have free trade agreements with one Central American country (either Nicaragua or Costa Rica) and one Andean Pact country, most likely Colombia or Bolivia.

Implications for Business

The international market environment is changing. The large industrial markets that have dominated the international scene for most of the postwar period have stalled and many are affected by political turmoil and uncertainty more common to the industrializing and smaller developing countries.

Moreover, because of the uncertain outlook for the General Agreement on Tariffs and Trade (GATT), regional trade arrangements are taking on increasing importance not only in North America but in Asia as well. This means that there is not only a shifting in relative market opportunities but also in the potential for large scale changes in the rules under which business operates. The following are several specific implications for business of these changes as they pertain to North America.

First, both the United States and Canada will remain highly competitive markets, with subpar growth and constant price and cost pressures that tend to reduce margins.

Second, seemingly small markets can offer big opportunities. The Mexican market offers real dollar opportunities in addition to the general advantages of dynamism. Growth in the Mexican market will make up an increasing share of the market growth in North America as a whole.

Third, Mexico represents an important gateway to Latin America. Mexico is actively pursuing free trade agreements with other Western Hemisphere countries which account for an increasing share of Mexican exports. There has been some talk about including an "accession" clause in NAFTA that would permit other Western Hemisphere countries to join by merely "acceding" to the terms of NAFTA, although the outcome is highly uncertain.

Fourth, although the negotiators have indicated that NAFTA will not attempt to rationalize the tariffs and barriers of the three partners with respect to products from outside of North America, non-NAFTA producers will face more stringent rules of origin (particularly in autos and textiles) and in some cases stricter standards (particularly in agriculture) than they do now. Nonetheless, despite changes in operating rules under NAFTA, North America will remain a relatively open export market.

Fifth, despite the obvious appeal of Mexico, tactical decisions about facility location will be based not only on labor cost differences but also on supplier links, educational and technology resources, and availability of public services within North America. These are the same criteria that govern the regional location within a given country.

Sixth, the very dynamism of Mexico is likely to increase capital flows to North America, although public deficits in Canada and the United States are likely to put pressure on long-term interest rates especially when private borrowing is also growing. Indeed, with a smaller trade deficit, the U.S. domestic markets will bear a greater burden of domestic financial requirements than during the 1980s.

Method

The Forecasting Process

The Conference Board, Inc. forecast for the U.S. economy is based on Conference Board analysis and simulations using the WEFA Group's econometric model. The WEFA Group is a private consulting firm specializing in economic research and forecasting, which also acts as a vendor for its proprietary econometric model of the U.S. and world economies. The Conference Board of Canada and CEESP forecasts are based on each organization's own proprietary model. The individual country forecasts are shown in 1986 Canadian dollars for Canada, and in 1980 pesos for Mexico (except where otherwise noted) in order to maintain consistency with other Conference Board of Canada and CEESP publications. The models are not linked in any direct manner other than to maintain comparability with the U.S. outlook.

North American Aggregates

In order to obtain aggregate growth rates for North America, actual and forecast data for Canada and Mexico were converted into U.S. dollars at average annual exchange rates. The following exchange rates were assumed: C $1.146/$ in 1991 and C $1.194/$ in 1992; 2906.2 pesos/$ in 1991 and 3169.6 pesos/$ in 1992.

Assumptions

The forecasts for all three countries assume a $18.86 per barrel refiners' average acquisition price for oil in 1992. The production, domestic demand, and other key elements in the U.S. forecast are used as the U.S. assumptions for the Canadian and Mexican forecasts as they provide a backdrop for the respective partners to forecast production and prices.

Simulations of the forecast for the U.S. economy assume no further fiscal and monetary stimulus beyond actions taken through March 1, 1992. The Canadian outlook includes all of the policies announced in the recent Canadian budget and assumes that no further interest rate increases will be required to support the Canadian dollar. The Mexican forecast assumes the continuation of the Economic Stabilization Program, of which the main elements are: a tight fiscal and monetary policy, a stable exchange rate policy, the continuation of trade liberalization, the privatization of public enterprises, and an aggressive deregulation program.

With regard to NAFTA, the medium-term forecast for Mexico assumes that an agreement will be reached. Though not making the same explicit assumption, it is doubtful that the medium-term forecasts for the United States, Canada or Mexico could be achieved in the absence of NAFTA because of Mexico's growing economic importance.

Revisions of Mexican Data

In March 1992, the Mexican statistical agency INEGI (Instituto Nacional de Estadística, Geografía e Informática) released final Mexican GDP for 1991. However, final estimates for the components, such as consumer spending, investment, etc., have not been released; therefore, all discussion of the Mexican economy is based on preliminary data.

Introduction

What does it mean to examine economic prospects for "North America" as separate from the individual countries? What is an economic region and when are the economic prospects of a region distinct from the sum of its individual countries?

There are no easy answers. The United States, Canada and Mexico are each far more different economically, socially and institutionally than they are similar. Economic regions almost always enjoy a high degree of integration, including the free flow of goods, capital and labor; and, they often operate with explicit exchange relationships and, to some degree, integrated economic policies and capital markets. A recent Conference Board report, *North America: The New Competitive Space*, describes the differences among the three North American neighbors as well as the chain of events that has led to the current historic effort to form a broad free trade area through a North American free trade agreement (NAFTA).

The recent commitment between the United States, Canada and Mexico to work toward a North American free trade agreement parallels efforts in other parts of the world to broaden national markets by liberalizing trade and investment across national borders. These regional efforts to lower tariff and nontariff barriers, and in some cases to extend economic integration to labor markets, social policy, financial markets and exchange rates, reflect the diminishing progress of broad-based multilateralism, like GATT. However, these efforts are also motivated by the desire of individual countries to capture the dynamic opportunities of larger, more competitive markets even if such markets extend across borders into neighboring countries.

This report describes the North American region primarily in terms of economic growth, trade and investment, and, to a much lesser extent, employment and wages. Other indicators like inflation rates, interest rates and exchange rates are largely determined by domestic economic policies and exchange-rate regimes in individual countries, as well as relative stage of development. These indicators are, therefore, treated in the context of the individual countries even though events and policies in one country have an important impact on the other two. These relationships are identified where appropriate.

This report focuses on the 1992 economic outlook for North America as well as the outlook for the United States, Mexico and Canada individually, and is the result of a cooperative effort between The Conference Board, The Conference Board of Canada, and the Centro de Estudios Economicos del Sector Privado, A.C. (CEESP). The projections are based on common assumptions with respect to macroeconomic policies as well as the rate and mix of economic growth in the United States. The report does not, however, quantify the possible effects of a North American free trade agreement although it presents a summary of recent studies on the long-term impact of a more open trade and market liberalization on the United States and Mexico. The method (see box on page 8) describes the sources and approach to the individual country forecasts and the projections for North America, as well as assumptions for each.

Trade Patterns in North America

Although on the surface North America appears to be far from meeting the strict criteria for an economic region, prospective elimination of tariff and nontariff barriers under NAFTA, common understandings on labor and environmental standards now developing as part of the free trade talks, and recent Mexican government policies to fix the relationship between the peso and the U.S. dollar are important steps in the direction of integration.

The extraordinary growth in trade and investment among the North American neighbors during the 1980s has intensified the economic relationships among the three countries. Although the U.S. market is still dominant because of its size, Mexico is increasingly important because it is such a rapidly growing export market for the United States and, potentially, for Canada.

During the 1980s, for example, trade between the United States and Canada doubled from about $84 billion to $165 billion while trade between the United States and Mexico grew 60 percent—from $25 billion to $40 billion. Canada remained the United States' largest trading partner; but Mexico moved up from fifth place to third, just behind Canada and Japan. Trade between Canada and Mexico remains limited.

From a regional perspective, the superb economic growth in Mexico over the past three years relative to either Canada or the United States has sparked remarkable export growth within North America. Exports between the United States, Mexico and Canada, now constitute more than 40 percent of the total export volume of the three countries, up from about one-third in 1980 (see Chart 1). This, however, is well below the level of intraregional trade in Europe which now accounts for well over two-thirds of all European trade.

The United States is by far the most important Mexican export market, accounting for 69 percent of Mexican exports. Imports from Mexico account for a larger share of U.S. imports than any European country, in most cases by a factor of two to three times. This includes the United Kingdom, which was the United States' second largest trading partner until 1959.

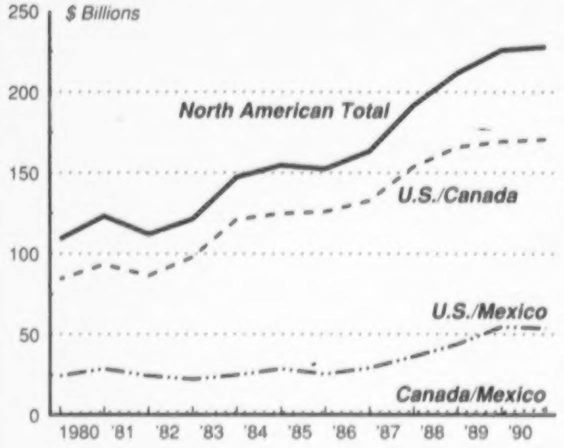
Correspondingly, Mexico is one of the United States' fastest growing export markets. Exports to Mexico account for 8 percent of total U.S. exports and grew 13.6 percent last year compared with 5.7 percent growth in total U.S. exports.

Mexican-Canadian trade totals only $3.3 billion. Canadian exports to Mexico did rise significantly from $469 million in 1990 to $627 million in 1991—still a very low base. However, Mexican-Canadian trade will undoubtedly develop as trade within North America grows and domestic markets open further.

In terms of output, Canada is about 10 percent as large as the U.S. economy; Mexico is 5 percent as large. Because of the size of the United States, large or sudden changes in economic conditions can have a serious impact on both Mexico and particularly Canada. Econometric estimates by The Conference Board of Canada suggest that a one percentage point increase (decrease) in the United States' growth rate can increase (decrease) Canadian export growth by as much as four percentage points during periods of early recovery (recession). During long expansions, growth in the U.S. economy translates into an equivalent amount of growth in Canadian exports. Generally speaking, cyclical changes in the economy are much less important to Mexico because the Mexican economy is currently driven by domestic forces.

Because Canada and Mexico are important export markets for the United States, economic weakness in either or both of these countries also reduces growth in the United States. For example, for every $100 increase in Mexican disposable income, $13 is spent on U.S. goods and services. Indeed, a severe recession in both Canada or Mexico whereby imports from the United States declined by 10 percent would reduce U.S. export growth by as much as 3 percentage points. Because both Canada and Mexico are important oil exporters, lower GDP growth in these countries is somewhat mitigated if accompanied by higher oil prices. Unfortunately, the corresponding rise in interest rates as a consequence of higher oil prices in all countries would likely offset any near-term benefit of higher oil prices to Canada and Mexico.

Chart 1: Increase in Intraregional Trade



Note: Inter-country trade represents sum of each country's imports from the other.
Sources: IMF Direction of Trade Statistics – various issues; The Conference Board; The Conference Board of Canada; CEESP.

Because certain sectors are increasingly integrated among all three countries, they can be more adversely affected than the individual economies as a whole. Although autos is most frequently cited among these sectors, textiles, electronics, pharmaceuticals, petrochemicals and chemicals are all developing important cross-border markets and production capabilities. Moreover, in anticipation of NAFTA, a number of industries, such as agribusiness and basic consumer goods, are integrating or planning to integrate U.S. and Mexican activities. This means that world demand, production and price trends that affect one country, are likely to affect all three.

Other Economic Links in North America

Although trade is probably the strongest tie among the United States, Canada and Mexico, the North American markets are interrelated in several other ways. Though labor markets among the three countries are almost totally independent, large wage and productivity differences between the U.S., Canada and Mexico are likely to narrow as Mexican development proceeds. Exactly how this takes place, and the impact it will have on the higher wage workers to the north, is very much part of the debate surrounding the free trade issue. Thus far, however, substantial wage growth in Mexico suggests that the primary effect of increased trade and investment is to raise Mexican wages and employment, rather than reduce the incomes of U.S. and Canadian workers.

Economic policy, financial markets and exchange rates in the United States, Canada and Mexico are also connected. The Mexican peso, for example, is formally tied within a narrow trading range to the U.S. dollar, while the spread between the Canadian and the U.S. dollar, though not so formally set, remains within a narrow range depending on the economic policy differences between the two countries. When the Bank of Canada runs an independent and restrictive monetary policy relative to the United States—as was the case in 1990 and early 1991—the impact is evident immediately in the appreciation of the Canadian currency.

Financial markets in the three countries are similarly related and independent. The sharp decline in U.S. interest rates during the past year has helped the monetary authorities in both Canada and Mexico reduce interest rates without worrying about their relative exchange rates.

On the other hand, bond markets in both Mexico and Canada have appreciated faster than in the United States, and the Mexican stock market has far outpaced both the United States and Canada. Mexico is indeed among the best-performing stock markets in the world, rising 140 percent last year.

These differences in bond and stock market performance relate to differences in liquidity in the individual national markets and in relative government and corporate financing requirements. In particular, Mexico has enjoyed the benefits of substantial foreign investment in Mexican stocks and bonds relative to Canada and the United States. This has helped keep Mexican bond rates low. Still, even with these important distinctions, shocks to equity prices in the United States can have a chilling effect in both Canada and Mexico, as was the case in October 1987, and again during the Persian Gulf oil shock of 1990-91.

Inflation is a different matter, with the rates among the three countries determined primarily domestically. To the extent that inflation is a "monetary phenomenon," the particular monetary policy stance in each country leads to specific inflation consequences. Where the economic structures and stages of developments are so different, as is the case in Mexico versus Canada and the United States, the very pace and mix of development in Mexico can, and does, have profound inflation consequences whatever the monetary target.

The intensifying trade relationships among the three countries, however, imply that should one country lose control of the price level, inflation can be exported to the other countries if the exchange rates do not adjust fully. In the past, for example, U.S. inflation has been a problem for Canada, where a one percentage point increase in the U.S. inflation rate raises Canadian prices by roughly 3 percentage points unless there is an offsetting change in the exchange rate.

Economic Outlook for North America

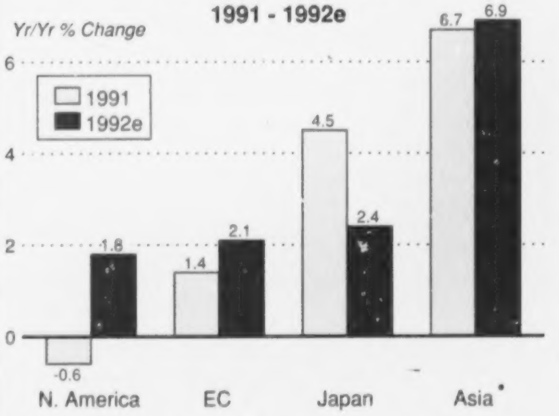
The near-term outlook in North America is driven more by structural adjustments in the United States and Canada than by the dynamic character of the Mexican economy. Over the next several years, as market and trade policy reform continue, economic advances in Mexico will change the character of North America, raising economic growth and offering important new market opportunities to businesses operating in the region. Equally important, because of higher U.S. and Canadian exports to Mexico and its own rapidly increasing trade relationships with Latin America, Mexico offers a unique gateway to greater trade and investment within the Western Hemisphere as a whole.

Because of the delayed economic recovery in both the U.S. and Canada, North America is expected to grow only 1.8 percent this year. This remarkably meager growth, especially for what should be the early expansion phase of the business cycle, is about the same or less than in Europe or Japan, and much slower than the growth expected in the Asian market economies. The rapidly growing economies in central and southeast Asia are a good proxy for the economic progress in the rapidly industrializing countries in other parts of the world as well. Chart 2 shows the 1991 and projected 1992 growth rates for these important global regions. The box below identifies the global regions discussed in the report.

In strictly quantitative terms, the very slow growth expected this year in the U.S. and Canada offsets the much more rapid growth in Mexico, as Chart 3 (page 14) illustrates. The difference in the near-term growth potential among the countries is even more striking from the perspective of relative domestic demand growth. Although consumer spending in the U.S. during the first quarter of 1992 staged an impressive recovery from its decline the previous fall, real disposable income growth remains limited to about 1 to 2 percent—excluding the effects of special factors like transfer payments and the reduction in federal income tax withholding rates. Given

Chart 2: Growth Rates for Selected Global Regions

1991 - 1992e



* Asian Market Economies include the following countries: South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand, Indonesia, and the Philippines.

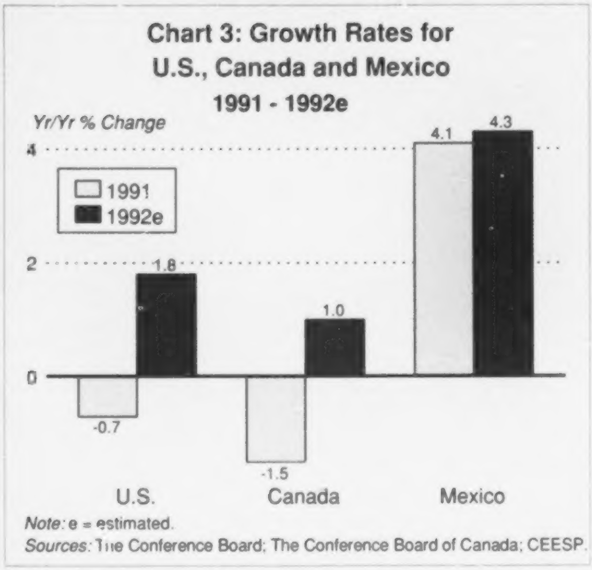
Note: e = estimated.

Sources: OECD Economic Outlook; Business Asia; The Conference Board; The Conference Board of Canada; CEESP.

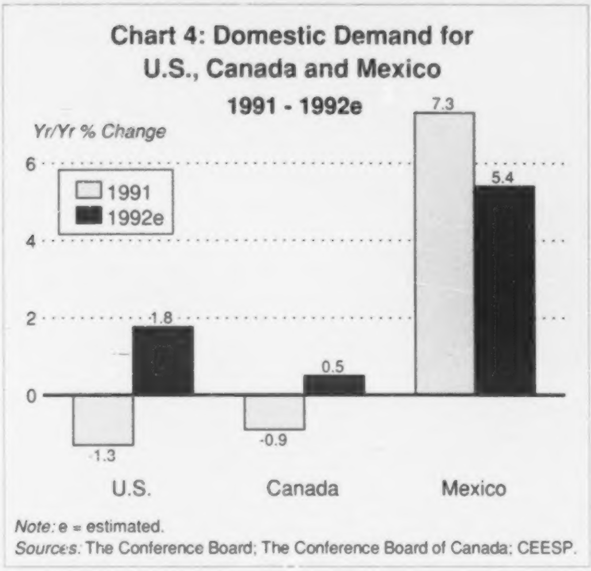
Global Regions

The following regions and country groups are referred to throughout the text. Asian market economies and Major Latin American economies are defined for the purposes of this report.

- **North America:** United States, Canada, Mexico
- **European Community:** Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, United Kingdom
- **Asian Market Economies:** Hong Kong, Taiwan, Singapore, South Korea, Malaysia, Indonesia, Philippines, Thailand
- **Newly Industrialized Economies (NIEs):** Hong Kong, Taiwan, Singapore, South Korea
- **ASEAN:** Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand
- **Major Latin American Economies:** Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Paraguay, Peru, Uruguay, Venezuela



Note: e = estimated.
Sources: The Conference Board; The Conference Board of Canada; CEESP.



Note: e = estimated.
Sources: The Conference Board; The Conference Board of Canada; CEESP.

the mediocre profit outlook and continued fiscal strains at all levels of government, there is little prospect that significantly higher employment or lower taxes will add to consumer incomes in any substantial way.

Sluggish Growth for the U.S. and Canada

Even excluding lingering effects of recession, growth in the United States has proved disappointing for several years. The U.S. is adjusting to the aftermath of the very long expansion of the 1980s, during which consumption and investment increased substantially—as much a result of rapidly rising indebtedness as higher real income growth. The process of bringing the level of private debt down began in 1989, accelerated with the decline in the economy beginning in July 1990, and has continued during an extended period of sluggish growth. Moreover, much of the service sector, which makes up over one-half of total output and almost 78 percent of total employment, is still in the process of adjustment to the overcapacity of the late 1980s.

At the same time, the industrial sector remains cautious about future production and investment, and employment remains near recession lows. The overcapacity and regulatory changes in the U.S. banking industry also hold back growth, as do the fiscal deficits at all levels of government.

Canada is weighted down in some of the same problems. The economic rebound recorded in Canada in the spring of 1991 ended in the fourth quarter with a decline in real GDP of 0.2 percent. Domestic profit and employment problems, combined with little strength in U.S. markets, and restraints from all levels of government, continue to hold back domestic demand there. Canadian economic policies have also conflicted over whether to stem inflation and support the Canadian dollar or to foster economic growth. Earlier this year, the Bank of Canada raised short-term lending rates to halt the fall in the Canadian dollar, but the economy proved too weak to sustain the higher rates. The new budget also added little if any stimulus to the Canadian economy. The last round of provincial budgets was rather restrictive, cutting spending and increasing taxes.

The U.S. and Canadian economies have followed a strikingly similar pattern of recovery and stagnation or outright decline—reflected in the ebb and flow of consumer sentiment in both countries. With little prospect of cyclical stimulus in the United States and possible restraint in Canada, domestic demand growth in both countries will be very weak this year.

Traditional fiscal and monetary policy measures are only part of the economic story. Canada usually grows faster than the United States during recovery periods because exports to the U.S. rise sharply in response to higher U.S. domestic demand at the same time that the cyclical sectors in Canada are also recovering. Growth in the U.S., on the other hand, is retarded somewhat because some portion of the domestic demand growth driving the U.S. recovery is satisfied by imports. In part, because of the very sluggish U.S. growth in 1992, Canadian exports are projected to grow only 2.9 percent. This, and stronger cyclical recovery in housing, accounts for most of the growth expected in Canada this year.

The inertia in the U.S. and Canada belies the economic opportunities in Mexico that will become an increasingly important force in the region. Domestic purchases in Mexico are projected to rise this year at a 5.4 percent annual rate—almost one-half the growth provided by capital goods. Although, as indicated earlier, the Mexican market makes up less than 5 percent of the total North American market, it will account for about 15 percent of the growth in North American demand this year. Chart 4 compares rates of domestic demand growth in the three countries.

Home-Grown Prosperity in Mexico

In the case of Mexico, traditional cyclical analysis is hardly relevant in explaining the vitality in the Mexican economy. Simply put, Mexico is enjoying the prosperity associated with radical economic reform, including abandoning the import substitution strategy it pursued for most of the post-World War II period, opening Mexican business to global competition, and privatizing key sectors and industries in the economy.

These actions have resulted in remarkable growth rates and even more impressive growth in private investment. The external benefits from this growth, in terms of both exports and direct investment, will promote growth in the United States and Canada during the 1990s. The prospect that South and Central America will follow Mexico's lead is a major source of long-term optimism about the export prospects for both Canada and the United States, as well as for Mexico. Indeed, the evolution of the free trade process could foster a western hemisphere "sphere of prosperity," such as that which existed in Asia during the 1980s.

The large gap in the domestic market growth between the United States and Canada on the one hand, and Mexico on the other, is indicative of the widening gap between domestic market growth in the industrialized countries and the newer, more aggressively industrializing countries worldwide. For a variety of reasons, including restrictive domestic economic policies, the domestic market growth in the mature industrial markets like Japan and Europe are hardly growing at all, while the domestic markets in the industrializing countries represented in this report by the Asian market economies are virtually exploding. Indeed, in a sort of economic role reversal from the 1980s, the mature industrial countries are likely to depend on growing exports to the domestic markets of industrializing countries in Asia and the Western Hemisphere as a major source of support for their manufacturing sectors. Chart 5 compares the relative domestic market growth for the key economic regions expected this year.

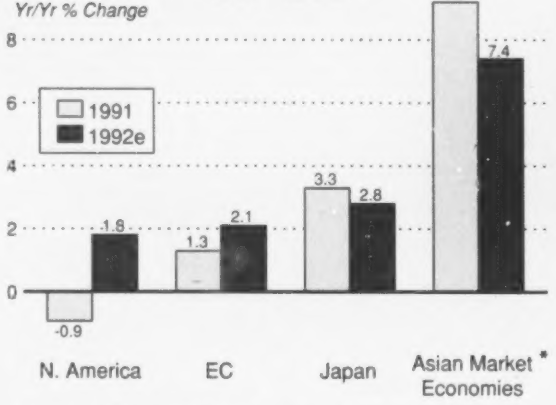
Gateway to Latin America

Although Europe and Asia rank first and second as North America's largest trading partners, Latin America may well offer greater opportunities for future trade. Chart 6 (page 16) shows the composition of North American trade. North American exports to Latin America are growing faster than to any other region of the world.

Latin American exports account for about 7 percent of total Mexican exports and are growing at a 7.4 percent annual rate over the past six years. As Mexico becomes an increasingly important economy, and as market reforms transform the South and Central American economies, the direction of export growth in North America will shift from Asia to the Western Hemisphere. In September 1991, Mexico signed free trade agreements with Chile which took effect January 1992. It is very likely that by year end Mexico will have free trade agreements with either Nicaragua or Costa Rica and one Andean Pact country, most likely Colombia or Bolivia.

Chart 5: Domestic Demand Growth for Selected Global Regions

1991 - 1992e



* Asian Market Economies include the following countries: South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand, Indonesia, and the Philippines.

Note: e = estimated.

Sources: OECD Economic Outlook; Business Asia; The Conference Board; The Conference Board of Canada; CEESP.

Trade Balance Continues to Shrink

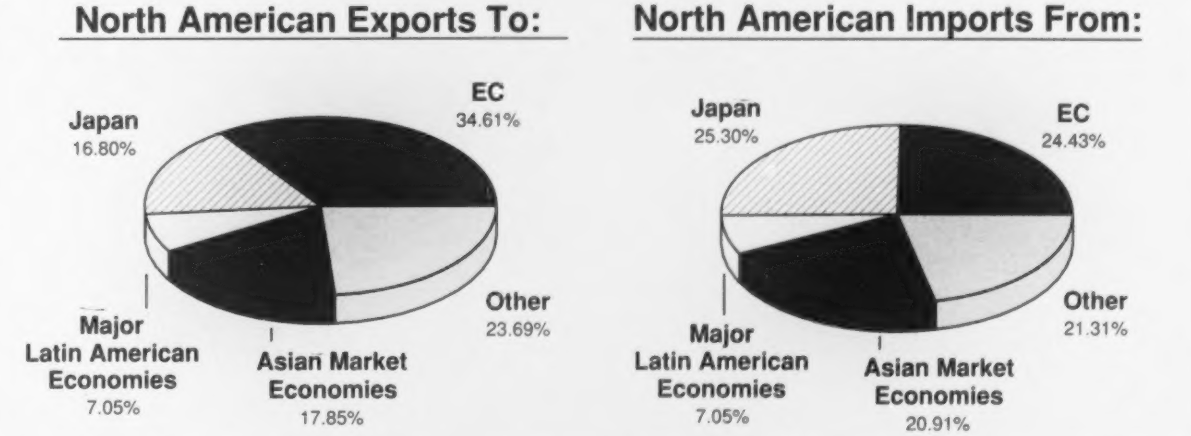
The relatively rapid domestic growth in Mexico is indicative of the impact of total North American demand on world markets. Trade among the three countries is still well below what might be required to satisfy domestic demand growth from production within the region. As a result, the North American trade deficit is projected to expand in 1992 for the first time in several years, as improvement in the U.S. trade balance stalls and the trade deficits in Canada and Mexico continue to grow.

Trade deficits for the European and the Asian market economies are also expected to widen while the Japanese trade surplus will likely increase. In contrast to the 1980s, when trade deficits were concentrated in the U.S., now virtually every major market region has a significant trade deficit while Japan continues to maintain a large trade surplus. Chart 7 (page 16) shows the North American merchandise trade balance compared with the European Community, Japan and the Asian market economies.

Investment-Driven Growth in Mexico Rises

While total business spending is expected to rise only slightly in the United States and to decline in Canada, investment in Mexico will rise at a 14.3 percent annual rate in 1992, the fourth consecutive year of

Chart 6: North American Exports and Imports by Region, 1991

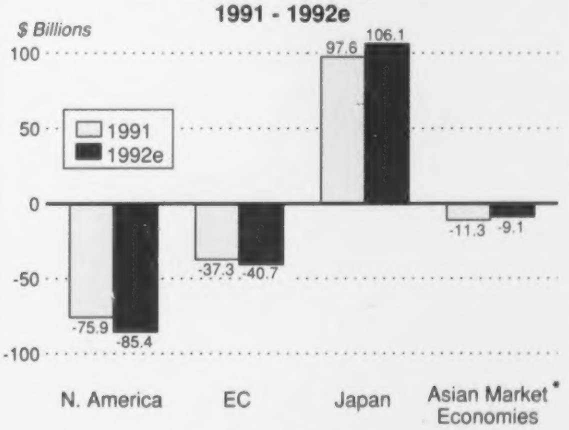


Major Latin American Economies: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Paraguay, Peru, Uruguay, and Venezuela.
Asian Market Economies include: South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand, Indonesia, and the Philippines.
Source: *IMF Direction of Trade Statistics.*

double-digit growth. Mexican investment accounts for almost two-thirds of all North American capital spending in dollar terms this year, even though the Mexican output is the equivalent of only about 5 percent of total North American output. Of course, this is due partly to the lingering effects of recession on capital spending in the United States and Canada. Still, if it can sustain the rapid investment growth of recent years, Mexico is likely to account for one-quarter to one-third of new North American investment even with a fuller recovery in Canadian and U.S. investment. Chart 8 shows the importance of Mexico as an emerging capital goods market.

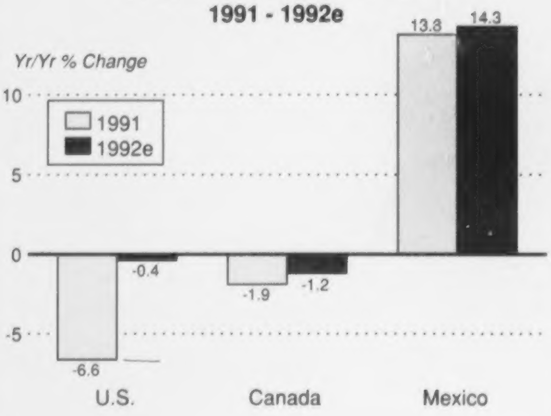
The relative dynamism of the Mexican capital goods market is evident in consumer markets as well. While consumer spending will grow only about 2 percent in the United States and will remain virtually flat in Canada this year—well below the long-term average of 3.0 percent or so for both countries—it is projected to con-

Chart 7: Merchandise Trade Balances for Selected Global Regions
1991 - 1992e



Asian Market Economies include: South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand, Indonesia, and the Philippines.
Note: e = estimated.
Sources: OECD Economic Outlook; Business Asia; The Conference Board; The Conference Board of Canada; CEESP.

Chart 8: Business Investment Outlook for U.S., Canada and Mexico
1991 - 1992e

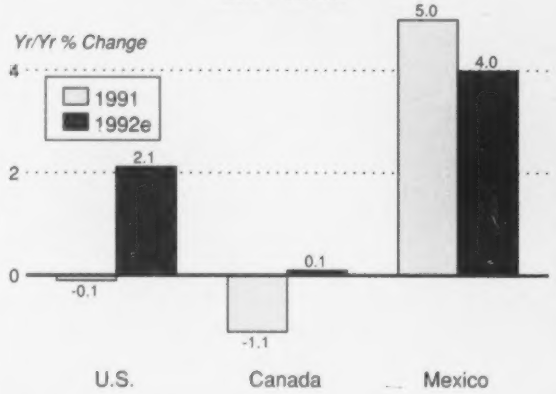


Note: e = estimated.
Sources: The Conference Board; The Conference Board of Canada; CEESP

tinue to grow rapidly in Mexico. Indeed, the overall projections for both economies understate the persistence of recession-like conditions that prevail in both the United States and Canada, particularly in the consumer sector. Consumer confidence in both countries followed similar patterns, rising in mid-1991 and then slipping back. Recently, consumer attitudes have improved in the United States as has consumer spending. Nonetheless, in the case of both the United States and Canada, real income growth will remain very sluggish throughout 1992, limiting the upside growth in consumer markets.

Consumer spending in Mexico, on the other hand, will grow at a 4.0 percent annual rate following a 5.0 percent gain in 1991. Thus, while North America will not be a particularly strong consumer market in 1992, Mexico will offer important market opportunities particularly in big-ticket consumer items like autos, which are currently weak in the United States and Canada. Chart 9 compares projected consumer market growth in all three countries for 1992. Table 1 compares the 1992 economic forecasts for the United States, Canada and Mexico.

Chart 9: Consumption Outlook for U.S., Canada and Mexico
1991 - 1992e



Note: e = estimated.
Sources: The Conference Board; The Conference Board of Canada; CEESP.

Table 1: Short-Term Economic Outlook, 1992

(Percentage Change, Except Where Noted)

	United States		*Canada*		*Mexico*	
	Actual 1991	*Projected 1992*	*Actual 1991*	*Projected 1992*	*Actual 1991*	*Projected 1992*
Nominal GDP	2.9	4.5	1.1	2.7	20.8	18.7
Real GDP	-0.7	1.8	-1.5	1.0	4.1	4.3
Real Consumer Spending	-0.1	2.1	-1.1	0.1	5.0	4.0
Real Capital Spending	-6.6	0.4	-3.5	1.7	13.8	14.3
Current Account Balance (bil $)	-8.6	-55.3	-26.8[3]	-30.2[3]	-13.3	-15.1
Unemployment Rate	6.8	7.1	10.3	11.0	2.7[4]	2.6[4]
Consumer Price Index	4.2	3.2	5.6	2.0	18.8	12.7
Refiners' Acquisition Cost of Oil ($/Bbl)	19.27	18.86	–	–	–	–
T-Bill Rate[1]	5.4	3.9	8.6	6.8	19.3	14.3
Long-Term Government Bond Rate[2]	8.1	7.8	9.5	8.5	18.6	14.9
Exchange Rate (per US $)	–	–	1.15	1.19	2906.2	3169.6

[1] U.S.– 3-month T-bill; Canada– 3-month T-bill; Mexico– 28-day CETES.

[2] U.S.– 30-year Treasury Bond; Canada– Federal Bonds greater than 3 years; Mexico– BONDES (Government Development Bonds) to 2 years.

[3] In Canadian dollars.

[4] Open unemployment in urban areas.

Note: For purposes of this forecast table, percent changes are based on the national currency forecast to maintain consistency with published TCB Canada and CEESP forecasts.

Source: The Conference Board, The Conference Board of Canada, CEESP.

U.S. Lags in Making Structural Budget Changes

In part, the huge foreign capital inflows to North America in the mid-1980s were needed to fund large public deficits in all three countries that drained domestic savings. While Mexico has made strides in bringing its public deficit under control, thereby restoring the domestic savings base, the United States and Canadian deficits remain at historically high levels. This year, for example, the U.S. budget deficit is projected to be the largest since 1983 both in absolute dollar terms and as a percent of GDP, while the Canadian budget deficit is projected to be about 3.6 percent of GDP in 1992. Chart 10 compares the projected budget balances based on broad measures of the deficit among the three countries.

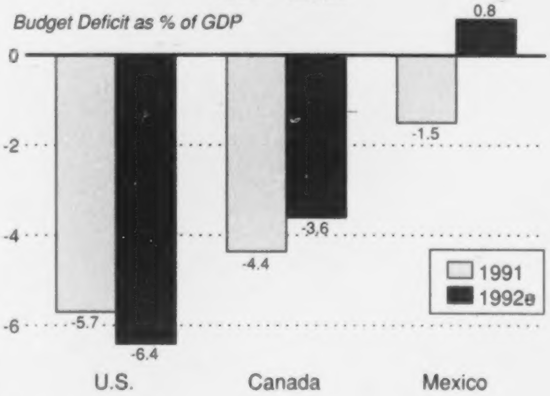
In contrast, Mexico's fiscal progress is striking. By the broadest measures, the federal budget in Mexico will be in surplus in 1992. With a dramatic program of control, the central government reduced spending from 30 percent of GDP in 1986 to under 20 percent by 1990. The Mexican federal government spending is less as a percent of GDP than the United States. Structural reforms, like the reduction of tax evasion and the elimination of many subsidies, are at the root of the better fiscal outlook. Indeed, Mexico is using the receipts from privatization to pay down public debt, which has declined from 32.3 percent of GDP in 1987 to a projected 12.5 percent in 1992. This compares with a GDP debt ratio of 51.9 percent expected in the U.S. this year.

Both the United States' state and local deficits and the Canadian provincial deficits have also deteriorated in the past few years. Though the state fiscal situation in the United States is slowly improving, 27 states have announced gaps in their 1992 budgets. While budget gaps are large and will require spending cuts or tax increases, the $8 billion deficit expected this year represents an improvement from the spring of 1991 when the states reported a total budget gap of $15.3 billion.

Since 1988, the total Canadian regional deficit increased even faster than the state deficits in the United States, with a gap of U.S. $8.4 billion now expected for 1992. This total regional government deficit is slightly bigger than the United States' state deficits even though the Canadian economy is only 10 percent as large.

The drop in foreign investment in the United States during the past two years suggests that an increasing share of large U.S. public deficits will have to be financed from domestic savings, which is lower as a share of domestic income than in either Canada or Mexico. As a result, public deficits in the United States, and to a lesser extent in Canada, compete more directly with private investment in the 1990s than was the case in the 1980s. In the absence of a substantial decline in public borrowing requirements or an equivalent increase in private savings, U.S. and Canadian investment will be lower, interest rates higher, or both, than would otherwise be the case.

Chart 10: Budget Deficit for U.S., Canada and Mexico 1991 - 1992e



Note: e = estimated.
Sources: The Conference Board; The Conference Board of Canada; CEESP.

Foreign Capital Shifting to Mexico and Canada

For most of the 1980s net foreign investment in North America rose to over $100 billion in 1989—most going to the United States. As shown in Chart 11, since 1989 foreign investment in North America has dropped dramatically—as has the growth in foreign investment worldwide. Foreign investment in North America declined to less than $1.0 billion in 1990 and recovered to only about one-third of its previous peak in 1991—with a strong foreign preference for investment in Canada and Mexico rather than the U.S.

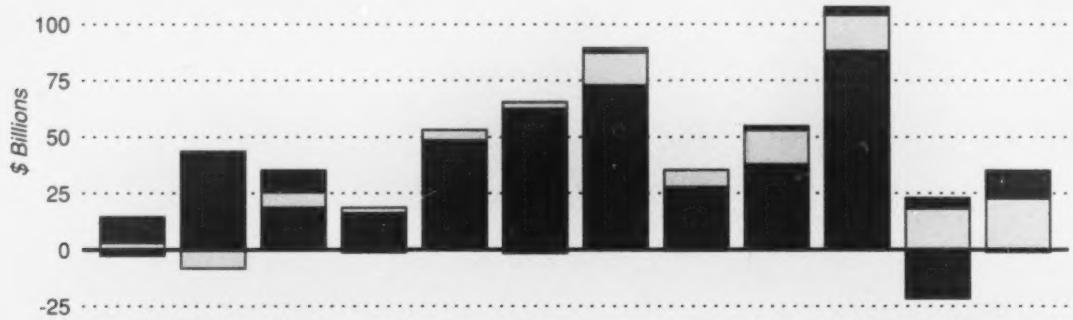
Over the past two years, for example, foreigners have added about $5 to $10 billion in new investment in both Canada and Mexico. The level of new foreign investment in Mexico is equal to about 3 to 4 percent of its GDP. Net foreign investment in the United States actually declined in both 1990 and 1991.

The mix of these capital flows is also telling. In the United States net foreign direct investment, which totaled $40.9 billion at its peak in 1988, fell to only $3.8 billion in 1990, and actually declined $7.3 billion in 1991. In contrast, foreign direct investment in Canada is running about $3 to $5 billion annually after declining for much of the 1980s.

In Mexico, foreign direct investment also continues to increase. In fact, it nearly doubled from $2.6 billion in 1980 to $5.0 billion in 1991. This means that Mexico is receiving an increasing share of a shrinking global pool of foreign investment capital. Indeed, foreign investment appears to be shifting away from southeast Asia to the Western Hemisphere.

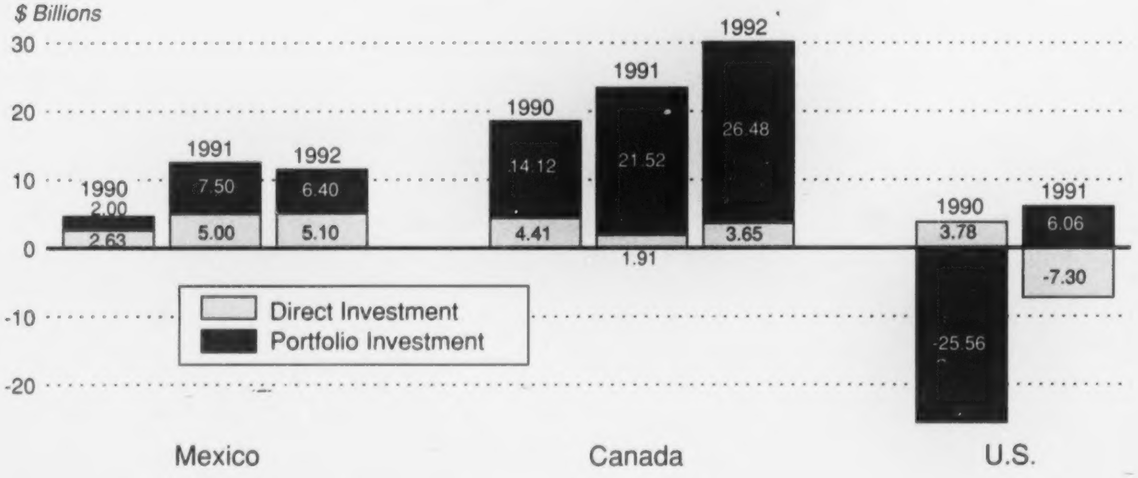
The differences in foreign portfolio investment are equally striking. Portfolio investment (i.e., net foreign investment in privately issued domestic stocks and bonds and government securities) rose dramatically in Canada

Chart 11: Total Foreign Investment in North America



	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
U.S. ■	-2.94	17.22	18.56	16.09	48.38	62.49	72.78	27.68	37.71	88.10	-21.79	-1.24
Canada □	2.97	-8.37	6.77	2.49	4.69	2.94	14.60	7.54	15.27	15.96	18.16	22.54
Mexico ■	11.44	26.36	9.75	-1.42	0.04	-1.81	1.84	-0.58	1.72	3.53	4.63	12.50
Total	11.47	35.21	35.08	17.16	53.10	63.62	89.22	34.65	54.70	107.59	1.00	33.81

Chart 12: Mix of Foreign Investment in North America



Sources: U.S. Department of Commerce; Bank of Canada; CEESP.

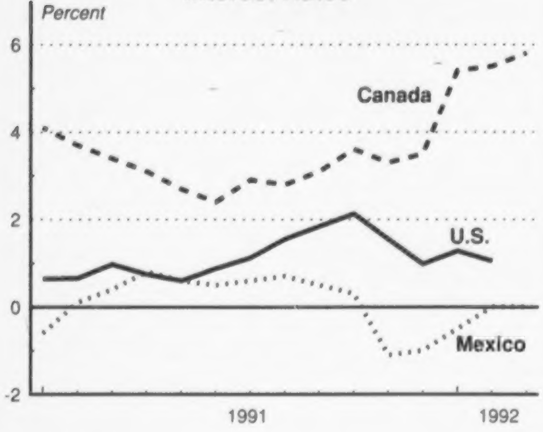
and Mexico last year and is projected to remain high or to increase this year. This is not particularly surprising in Canada where real interest rates have and continue to remain very high; but this does suggest remarkable investor confidence in Mexico, which already has a highly valued stock market, and where real returns in credit markets are only marginally positive. In addition to the flow of foreign capital to Mexico, Mexicans themselves have repatriated $2.9 billion this past year.

Although foreign portfolio investment improved dramatically in the United States last year, the 1991 level is only 8 percent of the 1986 peak. Unfortunately, U.S. foreign investment projections for 1992 are not available. Chart 12 compares the mix of foreign capital between direct investment and portfolio investment among the three countries.

Interest Rates Near Lows

Despite the impressive reduction in interest rates in North America to date, further significant reductions in short-term interest rates are unlikely for the balance of

Chart 13: Comparison of Real Short-Term Interest Rates



Sources: U.S. Department of Commerce; The Conference Baord of Canada; CEESP.

the year for three reasons. First, the Federal Reserve is constrained by the tendency of long-term interest rates to rise in the U.S. at the first sign of economic recovery. The Fed has the latitude to cut the federal funds rate by an additional 0.25 percentage points given the present 3.5 percent discount rate, and may take this opportunity should the economic recovery appear uncertain. This move would likely be more symbolic than real, however, because the U.S. yield curve is already steep. Lower short term-interest rates are not likely to induce long-term interest rates to come down—which are so important to the mortgage market. Moreover, the Fed is unlikely to set new aggressive targets for lowering interest rates unless long-term interest rates come down considerably.

Second, the change in commercial bank reserve requirements in the United States appears to signal the Federal Reserve's preference to provide additional monetary stimulus through means other than further interest rate cuts. Third, the balance of economic data over the first quarter of 1992 suggests that economic growth in the United States will improve, at least temporarily, which would make further interest rate cuts unnecessary.

Finally, although foreign investment in Mexico tends to bid up credit market prices and therefore depress interest rates, the Bank of Mexico will resist cutting short-term interest rates without significant improvement in the inflation rate. As noted earlier, the Bank of Canada may be compelled to keep short-term interest rates higher than they would be otherwise to support the Canadian dollar. Real interest rates in Canada are still above rates in the United States and Mexico. A weak currency exposes Canada to significant inflation risk because imports make up roughly 30 percent of GDP. As long as economic recovery in the United States is reasonably assured, however modest, both Canada and Mexico are likely to keep interest rates at current levels. Chart 13 shows the relative trends in the real short-term interest rates among the United States, Canada and Mexico.

Inflation Prospects Good but Not Great

A final constraint on North American interest rates is the inflation outlook. Inflation has declined sharply in all three countries in North America but probably is the best behaved in Canada. The Canadian inflation rate, as measured by the Consumer Price Index (CPI), averaged around 4.5 for much of the late 1980s and fell at a 0.4 percent annual rate between the third and fourth quarters of 1991. This year it is projected to rise at only a 2.0 percent rate. Lower inflation in Canada is the result of a substantial drop in wage growth and corresponding improvement in the Canadian dollar on holding import prices down.

Similarly, inflation has also come down in the United States from over a 6 percent annual rate at the end of 1990, to less than 3.0 percent by the end of 1991. Although it is projected to rise at only a 3.4 percent annual rate for 1992 as a whole, the inflation rate is likely to rise gradually from its present low to a more than 4.0 percent annual rate by year end. This higher rate would more closely reflect the core CPI inflation rate, which has remained in the 4.0 to 4.5 percent range for much of the recession and the early recovery period, as well as the limited improvement on the wage side.

Mexico, once again, finds itself in a very different inflation situation. The official Mexican forecast of a 9.7 percent rise in the CPI in 1992 appears unlikely to be achieved, in part because foreign capital flows into Mexico exceed the control of the central bank. Inflation is expected to rise at a 12.7 percent annual rate in 1992. While this is significantly better than the 20 to 30 percent inflation rates of recent years, experience suggests that given all the growth and liquidity pressures, inflation is always a risk in Mexico.

Competitiveness Is Improving

While comparable current data on relative wage and unit labor cost trends is not available, North American competitiveness appears to be increasing. Hourly wage rates in both the United States and Canada, which are running at about a 3 percent annual rate in both countries, are rising more slowly than many other industrial countries. Mexican wage rates are rising rapidly (4.9 percent in the manufacturing sector in 1991), but much of these increases are offset by higher productivity.

Manufacturing productivity gains are substantial in all three countries. In the United States, manufacturing productivity has been rising at a 3 percent annual rate for the past several years. Productivity performance in Canada, although dismal during much of the 1980s, has risen at a 1.5 percent average annual rate during the recent recession. As a consequence, unit labor costs in the United States and Canada have hardly risen at all in the past year and may have actually declined during the first quarter of 1992 in U.S. dollar terms.

Productivity in Mexico continues to rise at an extraordinary rate. Over the past three years, manufacturing productivity has risen a total of 20 percent. Of course, as indicated above, wages are also growing rapidly; so unit labor costs in Mexico are rising at about a 10.3 percent annual rate—albeit from a very low base.

An analysis by CEESP adjusts the relative wages in Mexico, the United States and Canada for differences in the productivity of the work force. This analysis shows that the relative wage differences among the three countries is significantly less than suggested by nominal average hourly wages because the overall productivity of Mexican workers is so much lower.

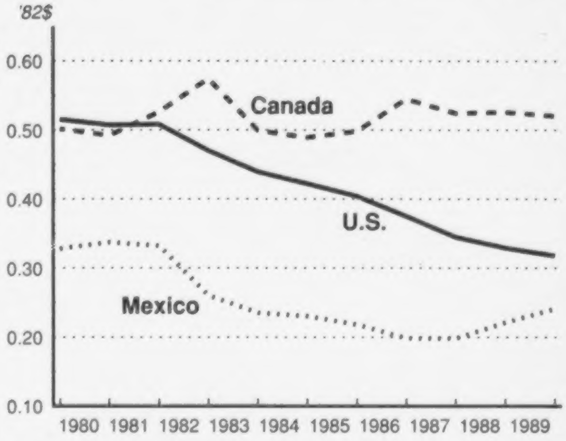
As a consequence, the unit labor cost differences which appear large in absolute terms are, indeed, much narrower—although the relative difference between Canada and Mexico remains wide. Chart 14 shows the trend in the relative unit labor costs in 1982 real dollar terms among the three countries that result from the CEESP analysis. U.S. competitiveness has improved relative to Canada—as a result of lower unit labor cost increases. Mexican unit labor costs appear to be rising relative to both the United States and Canada reflecting recent real wage gains in Mexico and a stable or declining cost structure in the United States. As this chart suggests, Mexico is losing a bit of competitiveness because of these rapid real wage gains—although this should be expected as part of the overall development process. Still, the loss in real wages during the mid-1980s in Mexico was so great that real wages remain at only 85 percent of their 1980 level even with the progress in real wages in recent years.

Exchange Rates Are Dollar Driven

The U.S. dollar dominates the exchange relationships in the region. As mentioned earlier, Mexico has established a formal relationship between the peso and the U.S. dollar; while the value of the Canadian dollar is more independent, it directly reflects the relative economic policy differences between the two countries. Under Mexican government policy, the peso is set to depreciate 2.5 percent per year within a band that permits variation of plus or minus 2.5 percent. This contrasts with Canada where, until recently, the Canadian dollar appreciated relative to the U.S. dollar because of higher real interest rates and a more stringent central bank monetary policy.

Over the past year or so, however, the Mexican central bank has had to intervene in order to stem a rise in the peso because of huge foreign capital inflows to Mexico. This will continue to be a policy management problem as Mexico attracts increasing foreign investment in Mexican stocks and bonds.

Chart 14: North American Unit Labor Costs



Sources: CEESP, with data from S.P.P. (Mexico's Ministry of Programming and Budgeting) and the U.S. Department of Commerce.

Canada, on the other hand, faces the opposite situation. After almost five years where the Canadian dollar appreciated a total of 23 percent versus the dollar, the Canadian dollar dropped 4 percent within a matter of weeks in February and March as a result of a dramatic shift in foreign capital out of Canada.

While the Canadian dollar stabilized briefly, foreign attitudes toward Canadian economic and constitutional problems are likely to create periodic pressure on the Canadian dollar. Thus, prospectively, foreign investment will create opposite pressures on the peso and the Canadian dollar. Huge foreign capital flows into Mexico will require further intervention or lower short-term interest rates (or both) to maintain the peso in its target range. Meanwhile, the risk in Canada is that interest rates will have to rise periodically, irrespective of the state of the economy, in order to control the value of the Canadian dollar.

Medium-Term Prospects

While this report focuses on the North American outlook for 1992, many of the differences among the three countries this year are likely to persist for the next several years. Real GDP growth for both the United States and Canada will be below the 1980s averages. Both countries appear to be undergoing economic changes that are not strictly related to the business cycle, particularly in terms of demographics and the use of debt. Moreover, the business sectors in both countries continue to improve global competitiveness which holds back employment growth. Mexico, on the other hand,

Table 2: Medium-Term Outlook, 1993-1995 Average

(Percentage Change, Except Where Noted)

	United States	*Canada*	*Mexico*
Real GDP	2.0	3.1	4.5
Consumer Price Index	4.3	2.7	10.6
Real Capital Spending	3.6	4.5	10.3
Unemployment Rate	6.7	10.1	2.4[4]
Current Account (bil $)	-43.7	-31.5[3]	-14.5
T-Bill Rate[1]	4.6	7.8	10.7
Long-Term Government Bond Rate[2]	8.4	9.4	11.5

[1] U.S. – 3-month T-bill; Canada – 3-month T-bill; Mexico – 28-day CETES.

[2] U.S. 30-year Treasury Bond; Canada Federal Bonds greater than 3 years; Mexico BONDES (Government Development Bonds) to 2 years.

[3] In Canadian dollars.

[4] Open unemployment in urban areas.

Note: For purposes of this forecast table, percent changes are based on the national currency forecast to maintain consistency with published TCB Canada and CEESP forecasts.

Source: The Conference Board, The Conference Board of Canada, CEESP.

will continue to enjoy high rates of investment growth as well as a growing consumer market that is the natural benefit of a rising standard of living. Table 2 compares the medium-term prospects of the three countries.

The Mexican economy is likely to continue to outpace the economies of the U.S. and Canada during the early 1990s although these gains represent an improvement from a very low base. During the 1980s, the prospect of more open markets and a broad-based North American platform for both marketing and production was an important magnet for foreign investment into Mexico as well as capital repatriation by Mexican nationals.

Today, Mexico requires continued foreign investment to add to its present capital base as well as to keep the cost of capital low for Mexican business. The 10 percent plus investment rates shown on Table 2 would be virtually impossible to achieve without substantial foreign capital associated with some form of a free trade agreement and further market liberalization to hold interest rates down. Indeed, the high growth rates in the medium-term projections are based on the explicit assumption that economic reform will continue and a North American free trade pact will be enacted.

With all of this said, it is always tempting to expect the future to look like the present, and there are several risks to these medium-term projections. The U.S. economy appears to be stuck near a cyclical trough from which it is not easily dislodged. While the recent consumer spending data suggest some recovery in early 1992, prospective limits on income and employment growth raise the likelihood that the U.S. economy will slow down once again and may be even weaker than the 2.0 percent these medium-term projections indicate. This has implications for both Canadian and Mexican exports.

Also, as discussed, while the formal North American free trade negotiations will be completed, final ratification is far from concluded. Once ratified, these negotiations will invariably have important implications for individual sectors and regions in all three countries. While neither the U.S. nor the Canadian forecasts explicitly assume a North American free trade agreement is implemented, failure to ratify such an agreement would lead to lower investment, lower exports, and probably higher interest rates than those shown in Table 2 for the whole of North America.

Status Report on North American Free Trade

On February 5, 1991, President Bush announced the North America free trade initiative. Subsequently, Congress granted the President "fast-track" authority to negotiate a free trade agreement with Mexico. Formal negotiations were initiated on June 12, 1991, between the United States, Canada and Mexico.

The negotiations are structured around six broad substantive issues, with 19 "working groups" assigned to traditional tariff and market access issues as well as to individual sectors. Not all working groups are expected to reach specific agreements. Several are organized to guide those groups with direct rule-making responsibilities.

In general, the negotiations have made progress. Differences among the three countries have narrowed in areas such as temporary entry (cross-border entry by business professionals for commercial purposes), most rules of origin aside from autos and electronics, and many textile-related issues. Wide disagreement remains in some of the most sensitive areas, such as autos, petrochemicals and energy, agriculture and financial services, which go beyond the authority of the working groups. Some key issues will have to be resolved among the heads of state of the three countries and, in the end, may require two bilateral agreements. The box on pages 24-25 describes the activities of the various working groups.

Impact of a Free Trade Agreement on the Outlook

This year's outlook for North America is fairly well set and is unlikely to be affected by the NAFTA negotiations. Of course, over the next several years, as mentioned earlier, NAFTA will have important consequences for all three countries, but particularly the United States and Mexico. The consequences of a free trade agreement are more modest for Canada since it will be more than a year before Canadian-Mexican trade is large enough to be significant to either country.

Even if concluded, it is unlikely that a North American free trade agreement would be considered in the U.S. Congress this election year, since important issues remain. In addition, the "fast track" process requires Congress to be notified 90 days in advance of actual text submission, and provides Congress with 90 legislative days. This could take a number of months.

The existing "fast-track" authority expires May 31, 1993. While the U.S. negotiators have committed to submit the agreement to Congress this year, the free trade pact must then be ratified by both Canada and Mexico. It is unlikely that any of the conditions pertaining to NAFTA would be in place before late-1993 or early 1994.

While NAFTA has strong Congressional support, a favorable outcome is not a foregone conclusion. The composition of next year's Congress will change substantially. Given the retirements announced to date, there may be more non-incumbents in the next Congress than at any time since 1948. This adds uncertainty to the next Congress' free trade stance.

Much of the current dynamism in Mexico and U.S.-Mexican trade growth is the result of the dramatic tariff reductions in the mid-1980s. As discussed in The Conference Board report, *North America: The New Competitive Space*, Mexico unilaterally reduced its average effective tariff of about 25 percent in the mid-1980s to a current effective rate of just over 10 percent compared with the U.S. effective tariff of 4 percent. Moreover, as recently as the end of 1984, Mexico required a license for every import into Mexico. These licensing requirements have been virtually abandoned—except in agriculture—which makes up about 3 percent of all tariff items. Certainly, further liberalization would bring gains, since there are many sectors where the effective tariff differences between the United States and Mexico are 20 percent or more. Nonetheless, past tariff liberalization has already intensified trade relationships between the two countries and increased investment in Mexico.

At this point, nontariff barriers and right of establishment issues are more important. Elimination of such barriers boost trade and investment as much as, or more than, tariff changes that have occurred thus far. While there is little prospect for completely eliminating these barriers, the scope and progress of the trade talks suggest that they will be greatly reduced. Equally important, the free trade agreement will include an agenda on

North American Free Trade Negotiating Groups

The NAFTA negotiations are structured to address six substantive issues, including Market Access, Trade Rules, Services, Intellectual Property and Dispute Settlement. The following is a summary of the working groups within each broad issue area.

I. MARKET ACCESS

Tariff/Nontariff Barriers

This working group focuses on the elimination of all tariffs on 27,000 of tariff line items. It also concentrates on the all nontariff barriers (e.g. import licenses, quotas) and other practices such as regulation that govern imports more restrictively than domestically produced goods. All countries have agreed that no products would be excluded from the tariff negotiation.

Rules of Origin

These negotiations build on the "change in tariff classification" rule that requires a product be sufficiently transformed in one of the North American countries in order to change its tariff classification. This working group will seek to strengthen "rules of origin" in specific sectors such as automobiles.

The treatment of auto production and parts is a key issue. The United States favors elimination of domestic content within North America and strengthening rules of origin for producers outside the region. The Mexicans favor retention of a minimal domestic content limit, even within the region, or extended implementation to ease the transition for Mexican suppliers, particularly for auto parts.

Government Procurement

This working group is reviewing the U.S. government procurement rules contained in the Canadian Free Trade Agreement to determine whether the same rules can be applied to Mexico. The Canadian Free Trade Agreement provides a more open government procurement threshold than does GATT. A key NAFTA objective is to alter government procurement practices to provide greater ease of understanding to suppliers from all three NAFTA countries.

Agriculture

Agriculture is an important component of North American trade accounting for $13 billion in total trade in 1990. The purpose of this working group is to review all tariff and nontariff barriers among the three countries to eliminate, or in the case of nontariff barriers like inspection standards and certain health regulations, to reduce or modify them.

Automotive

Automotive trade (including parts) makes up about $59.0 billion in three-way trade in North America. It is also a sector in which both the Mexican Auto Decrees and the U.S.-Canada Auto Pact have had a major impact on trade and investment flows. In particular, the Mexican Auto Decrees required forced investment to get market access, whereas the US-Canada Auto Pact accorded preferential treatment based on local production. The intention is for NAFTA to create an integrated, rationalized and competitive North American automotive industry.

Textiles and Apparel

This working group is examining the feasibility of replacing tariffs and quotas in this sector, replacing them with a sufficiently strong rule of origin to ensure that the advantages of freer trade accrue to North American producers. Understandings have been reached between the United States and Mexico on a wide range of issues although there remains important Canadian reservations.

Energy and Petrochemicals

The United States and Canada have agreed to respect Mexico's constitutional limitations of foreign ownership of their hydrocarbon reserves. This working group is exploring other opportunities to enhance trade in petrochemicals, natural gas trade, and energy equipment and services.

II. TRADE RULES

Safeguards

All three countries agree that it is important to have certain "safeguards" in place in case imports of a particular good increase to such an extent that they harm a domestic industry or farm sector. As part of the safeguard system, the United States seeks a provision to protect its industry from large increases in imports from either Canada or Mexico and a global provision to maintain the ability to limit NAFTA imports from all sources.

Antidumping, Subsidies, Countervailing Measures

The objective of this working group is to improve transparency of laws and regulations against unfair trade. Although all three countries have laws against unfair pricing and subsidized goods, there are significant differences in the administrative and judicial procedures related to these laws. Mexico has questioned the applicability of such laws in a free trade area, yet the United States believes it is inappropriate to have separate antidumping and price regimes under NAFTA.

Standards

Guidelines for standards setting and enforcement are needed to deal with the possibility that, as trade barriers are eliminated, standards might be used to establish unwarranted barriers to trade. There are three sub-working groups in the standards category: Sanitary/Phytosanitary, Health/Environment and Industry. These groups are not negotiating specific standards but rather the processes by which standards and technical regulations are established. Such elements of the standards setting process include transparency, equal treatment and scientific basis.

III. SERVICES

Services trade comprises many sectors such as insurance, financial services, transportation, telecommunications, professional services, and others. The following are a number of the working groups under the Services category.

Principles: This is the broadly defined working group that is charged with issues that affect all services. The key issue is national treatment—foreign service companies should have the right to establish a company and offer services in the country on the same basis as a national company.

Temporary Entry: The objective of this working group is to facilitate the temporary entry within North America of NAFTA country professionals and managers engaged in trade and investment activities.

Financial Services and Insurance: This working group has focused on the rules that will govern trade in financial services, specific barriers to be eliminated, and cross-border transactions.

Land Transport: This working group is charged with negotiating liberalization of current restrictions on the transportation industry, such as laws prohibiting foreign-owned or operated motor carriers from doing business in a country. These industries include railroads, trucking, and local/intercity transit service.

Telecommunications Services: This group is working to ensure the access and use of the services of the public telecommunications network for the provision of covered goods and services.

Other Services: The negotiators are primarily discussing regulations pertaining to professionals. The United States and Canada have argued that the U.S.-Canada FTA provides a good blueprint in this case.

IV. INVESTMENT

The parties generally agree that North American firms should be able to establish subsidiaries or branches, operate partnerships, or acquire companies in either partners' country. For the United States, this also implies national treatment, the right to repatriate profits, and access to arbitration. Each side recognizes that, in certain sectors, open investment may be "off limits," though the United States wants to restrict these to a minimum necessary only to ensure vital national interests. The principles negotiated by the investment working group would govern investment in all goods and services, with exceptions to be negotiated.

V. INTELLECTUAL PROPERTY

The leaders of the United States, Canada and Mexico are committed to the protection of intellectual property. The United States, among other goals, seeks to ensure adequate and effective protection for patents, trademarks and copyrights. The parties have exchanged information on national laws and practices in areas of enforcement and protection of intellectual property rights and identified issues which need to be resolved.

VI. DISPUTE SETTLEMENT

The objective of this group is to create a flexible, pragmatic oversight and consultation mechanism for North America, similar to that contained in the U.S.-Canada Free Trade Agreement. When consultations are not sufficient to resolve a problem, swift, fair and effective panel procedures should provide an alternative.

long-term issues, which will be negotiated through the end of the decade. Thus, NAFTA negotiations, rather than a single event with definable benefits, are an ongoing process of opening markets and integrating relative cost and productivity advantages among the three countries.

Study Comparison

Many studies have attempted to identify the costs and benefits of a North American free trade pact. Although these studies vary widely in methodology, they reach similar conclusions. Table 3 compares a range of findings on the impact of NAFTA and related reforms on the United States and Mexican economies.

Freer trade between the United States and Mexico will lead to a substantial increase in trade between the two countries—although generally U.S. exports will rise more. In addition, freer trade between the two countries will have little effect on U.S. and Mexican trade with the rest of the world, except in the Almon and KPMG studies, which show an increase in trade between the two countries, as well as with other countries.

The most important effect of freer trade, however, will not be in the trade accounts themselves but in the employment growth of the two countries. Most studies show that both countries will gain jobs; only one study shows large employment losses for each.

The difference in results is partly due to different assumptions and methodologies. The Baylor Study, for example, assumes full elimination of tariffs but only partial elimination of nontariff barriers. The Institute for International Economics study not only eliminates tariffs but also assumes a continuation in major policy reform. The Berkeley, Michigan-Tufts and El Colegio models assume fixed employment levels, hence they generate relatively large wage gains in Mexico.

When comparing possible job losses to the relative size of each work force, Mexico would appear to be at greater risk than the United States. Still, because exports have remained so strong in both countries during the past five years and tariff barriers have been substantially reduced, it is difficult to envision large employment losses in the aggregate for either country.

Table 3: United States and Mexico: Alternate Projections of Changes as a Consequence of NAFTA[a]

(Billions of Dollars Except Where Noted)

	IIE	*Almon*[b]	*KPMG*[c]	*Berkeley*[d]	*Baylor*[e]	*Michigan-Tufts*[f]	*El Colegio*[g]
U.S. exports to Mexico	16.7	8.5	1.2	2.3	6.9	4.2	3.4
Mexican exports to U.S.	7.7	2.7	3.9	2.5	5.1	3.5	1.3
U.S. net exports to rest of world	0.0	0.2	1.6	0.2	N.A.	-1.0	N.A.
Mexican net exports to rest of world	-3.0	3.1	1.3	-0.2	N.A.	0.5	-1.3
U.S. trade balance	9.0	6.0	-1.1	0.0	1.8	-0.3	2.1
Mexican trade balance	-12.0	-2.7	4.0	0.0	-1.8	-0.2	0.0
U.S. employment (thousands of workers)	130	44	0	-234	N.A.	0	0
Mexican employment (thousands of workers)	609	-158	1,464	273	N.A.	0	0
U.S. wage rate (percentage change)	0.00	0.02	0.03	0.40	0.01	0.10	N.A.
Mexican wage rate (percentage change)	8.70	N.A.	0.00	2.27	N.A.	2.90	16.00

N.A. = not estimated or not available

[a] The econometric and computable general equilibrium (CGE) models (all except the IIE model) generally assume elimination of tariffs and total or partial elimination of nontariff barriers. However, the Baylor model only eliminates tariffs. The IIE historical model assumes elimination of all trade barriers and continuation of major policy reforms, including liberalization of Mexican energy policy. The econometric and CGE models usually do not incorporate the effects of policy reforms, outside of trade liberalization. The dollar figures are expressed in terms of 1988 or 1989 price levels. The Berkeley, Michigan-Tufts, and El Colegio models assume fixed levels of employment and hence generate relatively large wage gains in Mexico. The wage gain in the IIE model reflects real appreciation of the peso.

[b] The trade figures in the Almon report are based on 1977 price levels. They were adjusted to 1988 price levels by applying a multiple of 1.70 (based on the U.S. producer price index for industrial commodities). The employment figures in the Almon model are for the year 1995.

[c] The KPMG model summarized here assumes that the FTA spurs an additional $25 billion of investment in Mexico. The model is specified so that the change in the U.S. employment level and the change in the Mexican wage rate are both zero.

[d] The Berkeley model summarized here is described as the pro-competitive trade liberalization model. It reflects reduced distortions in U.S. and (especially) Mexican capital allocation, together with complete trade liberalization. The wage rate figures in the Berkeley model are weighted averages for various skill categories. The decline in U.S. employment largely reflects a return flow of illegal immigrants to Mexico.

[e] The percentage change figures in the Baylor study are applied to 1989 trade flows to produce these estimates.

[f] The Michigan-Tufts results summarized here are roughly calculated as the difference between the reported NAFTA results with investment liberalization that leads to a 10 percent increase in Mexico's capital stock, and the Canada-U.S. FTA results. The NAFTA results in the Michigan-Tufts model reflect a partial rather than a total relaxation of agricultural and textile nontariff barriers.

[g] El Colegio results summarized here specify zero change in Mexican employment, but allow Mexican capital stock to increase.

Note: The following are the sources for the respective models: 1) Institute for International Economics (IIE) Model: Gary Clyde Hufbauer and Jeffrey J. Schott, *North American Free Trade: Issues and Recommendations* (Washington, D.C.: Institute for International Economics, March 1992); 2) KPMG CGE model: KPMG Peat Marwick, Economic Policy Group, *The Effects of a Free Trade Agreement Between the U.S. and Mexico* (Washington, D.C.: KPMG Peat Marwick, May 1991); 3) Almon econometric model: Interindustry Economic Research Fund, *Industrial Effects of a Free Trade Agreement Between Mexico and the USA* (Washington, D.C.: U.S. Department of Labor, September 1990); 4) Berkeley CGE model: Raul Hinojosa-Ojeda and Sherman Robinson, *Alternative Scenarios of U.S.-Mexico Integration: A Computable General Equilibrium Approach* (Berkeley: University of California, Division of Agricultural and Resource Economics, 1991); 5) Baylor CGE model: Roy G. Boyd, Kerry Krutilla, and Joseph A. McKinney, *The Impact of Tariff Liberalization Between the United States and Mexico: A General Equilibrium Analysis* (Waco, TX: Baylor University, Hankamer School of Business, 1991); 6) Michigan-Tufts econometric model: Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, *A North American Free Trade Agreement: Analytical Issues and Computational Assessment* (Ann Arbor, MI; University of Michigan, and Medford, MA: Tufts University, 17-28 June 1991); 7) El Colegio de Mexico CGE model: Horacio E. Sobarzo, *A General Equilibrium Analysis of the Gains from Trade for the Mexican Economy of a North American Free Trade Agreement* (Mexico City: El Colegio de Mexico, June 1991).

Source: Institute for International Economics, *North American Free Trade: Issues and Recommendations*, G. C. Hufbauer and J. J. Schott (Washington, D.C.: March 1992)

North American Outlook: Implications for Business

The international market is changing. Domestic markets in large industrialized countries, such as the United States, have stagnated. At the same time, rapidly industrializing countries, like the Asian market economies, are increasingly driven by domestic market forces. Emerging markets enjoy high rates of investment growth and a corresponding rise in real incomes and living standards. As a consequence, most large economies in terms of population and market potential are developing dynamic and increasingly sophisticated consumer markets—often in industries such as autos, which are so distressed in countries like the United States. Indeed, the industrializing economies represent important export opportunities for the industrialized countries, which have come to depend on exports to support their manufacturing sectors. This is very different from the past 20 years, when the NIEs were export driven and, therefore, highly dependent on large industrial markets.

Moreover, while the outlook for GATT has improved recently, regional trade relationships are increasing in importance as countries look for ways to expand domestic market opportunities. The ASEAN countries, for example, have begun discussions aimed at reducing tariffs and expanding trade and investment within the ASEAN group.

North America is a microcosm of this change. The domestic economies in both the United States and Canada are expected to grow very little in the next few years, while the Mexican market is literally booming in many areas. Accordingly, Mexican imports are increasing rapidly with the United States as the principal supplier. NAFTA will further accelerate trade and investment within North America, although the elimination of tariffs and nontariff barriers will change profit margins in many important sectors. Several specific implications for business are as follows.

First, there are important disparities in the growth rates of the United States and Canada, on the one hand, and Mexico, on the other. Both the United States and Canada will remain highly competitive markets; however, substantial unit gains will be difficult to sustain in most industries and prices and margins will remain under pressure. Cyclical improvement in profitability will therefore prove disappointing and most profits will be made from specific product, price and quality decisions, rather than from a rapidly growing economy.

Second, while Mexico is an important market in terms of sheer dynamism, it also offers significant opportunities in purely dollar terms. Although the Mexican economy is relatively small, business investment, which makes up almost 20 percent of GDP, is rising at a 14 percent annual rate compared with virtually no growth in the United States at all. In 1992 alone, the dollar value of the Mexican capital goods market will exceed that of the recession-depressed United States.

Over the 1993-95 period, business spending will grow almost three times faster in Mexico than in the United States. Thus, although the annual increase in real dollar U.S. demand will be on the order of $70 to $100 billion, the growth in the Mexican market will be one-quarter to one-third as great.

Third, Mexico represents an important gateway to the rest of Latin America. Mexico is actively pursuing free trade agreements with other Western Hemisphere countries; already, these countries account for an increasing share of Mexican exports. While a specific "accession" clause in NAFTA, which would ease the way for other Western Hemisphere countries to join is unlikely, the rapid reduction in tariff and nontariff barriers through a wide variety of trade agreements will accelerate market access.

Fourth, although NAFTA will not contain common tariffs or barriers with respect to products, non-NAFTA producers will face more stringent rules of origin (particularly in autos and textiles) and in some cases standards (particularly in agriculture). Despite changes in operating rules under NAFTA, however, North America will remain a relatively open export market.

Fifth, despite the obvious appeal of Mexico, facility location within North America will be based on supplier links, education and technology resources, and availability of public services as much as on relative labor costs. Indeed, these same criteria govern regional location decisions within a given country.

Sixth, the very dynamism of Mexico is likely to increase capital flows into North America from outside the region, which will be important in holding down the cost of capital. While Mexico will benefit most in this regard, both Canada and the United States will profit by association. Indeed, since the Mexican stock market is highly valued, Canadian and U.S. companies with extensive operations in Mexico may benefit from value-seeking investors.

Nevertheless, public deficits are likely to put increasing pressure on long-term interest rates in Canada and the U.S., especially during periods when private borrowing is also growing. With a smaller trade deficit and lower net capital flows, U.S. domestic financial markets will bear a greater burden than during the 1980s.

United States Outlook

The Conference Board

Consumer spending surged early in 1992, followed by an increase in industrial activity and a continued recovery in housing. All of these factors point to the start of a new "growth phase." The 5 percent plus annual growth rate in consumer spending in the first quarter depleted inventories, and with the pickup in industrial activity consumer incomes will rise.

Nonetheless, this sharp jump in consumer activity is not sustainable since it was due to a largely one-time rise in transfer payments. With little suggestion of new hiring and no employment growth, consumer markets will remain constrained by the 1 to 2 percent annual growth in real incomes of the past year. This is well below the growth required for consumer purchases of "big ticket" items like automobiles. Indeed, while employment has improved relative to a year ago, the loss of jobs relative to the weakness in output is greater than at anytime during the past 20 years. Chart 15 (page 32) compares the relationship between employment and output changes in 1990-92 to past economic cycles.

With slow growth in much of the industrialized world, a significant pickup in U.S. domestic demand is likely to attract higher imports. The resulting competition with domestic producers which will hold down growth, compounded by the tendency of long-term interest rates to rise sharply at any hint of recovery, have a leveling effect on two of the most important engines of recovery: housing and the consumer—mortgage refinancing applications fell 56 percent from January to March.

Sources of Subpar Growth

The U.S. economy has had difficulty staging a significant economic revival for several reasons. First, the economy has never entered a sustained recovery without a change in government policy, other than lower interest rates. In most cases, such as 1975-76 and 1981-82, that policy change took the form of a broad-based tax cut. In 1971, President Nixon's Wage Price Stabilization program had much the same effect; it created a wedge between wages and prices that increased corporate profitability and led to a boom in business investment.

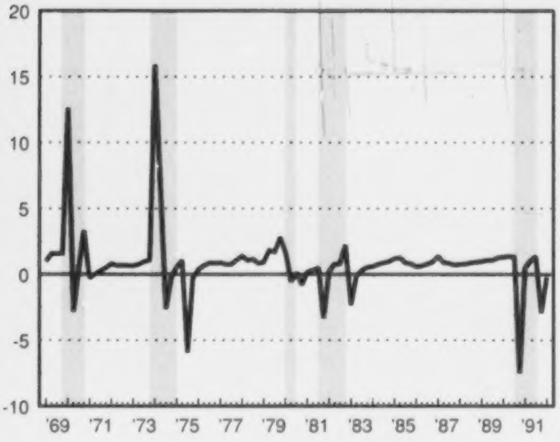
This year, there has been no similar action. True, withholding rates have been reduced by an annual equivalent of $25 billion dollars, federal grant spending has been accelerated, and in January certain entitlement payments were paid out in a lump sum rather than in quarterly installments. Still, all of these actions are temporary in nature and they borrow growth from the future rather than create a basis for sustainable recovery. In particular, reduced withholding rates increase disposable income at the expense of intended savings. Of the taxpayers who receive this near-term benefit, approximately 10 percent will have to pay 1992 tax liabilities.

Second, the liquidity normally created by a recession and early recovery phase is not now present. This liquidity is important because it represents a stock of income available to support both consumer and business spending.

Outlook at a Glance

- U.S. economy in new "growth phase"
- Slowdown probable by year-end
- "Supply-side" restraints on employment growth will continue
- Short-term interest rates are at or near lows
- Yield curve will remain historically steep
- No more fiscal action to help stimulate the economy is likely until after the election
- Wage, benefits and nonwage costs raise prices where possible or reduce profits
- U.S. dollar is at risk as disappointment over economic performance emerges

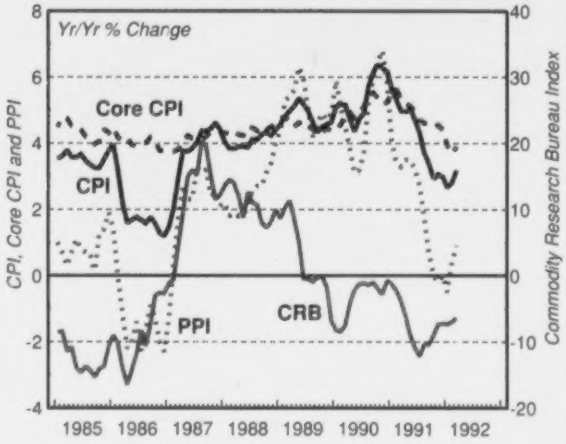
Chart 15: Employment / Output Ratio



Note: Ratio is $\frac{\text{year-to-year change in nonagricultural employment}}{\text{year-to-year change in GDP}}$

Sources: Bureau of Labor Statistics; U.S. Department of Commerce.

Chart 16: CPI, Core CPI, CRB and PPI



Note: Core Inflation = CPI excluding food at home and energy. Commodity Research Index (1967 = 100).
Sources: Bureau of Labor Statistics; Commodity Research Bureau.

During past recessions, for example, consumer spending fell faster than consumer income and savings rose. In 1990-91, however, consumer spending and incomes declined at similar rates with no increase in the already low savings rate. Consumers tended to dip into savings to maintain their standard of living in the face of rising unemployment.

Business liquidity is also lagging. Although corporate profits, thanks to cost cutting and some productivity increases, remained relatively flat during the recession, corporate profits had already declined at an 11.5 percent annual rate in the year leading up to the recession. Coming out of a recession, corporate profits and cash flow normally rise providing the resources for inventory building and business expansion. Since the trough of this recession, corporate cash flow, like corporate profits, has essentially been flat.

Lower interest rates have helped create liquidity for both business and consumers that has not been created by the pace of economic activity itself. Lower mortgage interest rates have prompted refinancings, adding about one-half of one percentage point to personal disposable income. However, some of this improvement has been offset by lower interest income.

Lower interest rates have also led to better business balance sheets as high yield debt is retired and new equity issues replace both short- and long-term debt. While the cash generated here is certainly one reason why business investment surveys indicate a significant, if moderate, increase in capital spending in 1992, this new spending will be concentrated in productivity enhancing investment rather than in the types of capacity which are an important source of new jobs.

A third important difference between the current period and past "recoveries" is the breadth of unemployment. In the past, recessions often hit isolated sectors and regions of the country. During the past two or three years, though, virtually every industry and region has experienced some job losses—with the coastal regions and the Northeast particularly hard hit. While the recent improvement in consumer confidence is encouraging, it is partly based on improved job expectations which must be fulfilled if better confidence is to be sustained.

Costs Remain an Inflation Problem

The rate of inflation, both at the consumer and producer level, has come down substantially in the past 18 to 20 months. The CPI peaked at a year-over-year rate of 6.4 percent in the fourth quarter of 1990. The core CPI (which excludes the effects of food and energy) has slipped about one-half percentage point in the past few months. Virtually no prices increased at the producer level, and commodity prices have only recently stabilized after a sharp decline. Chart 16 shows the trend in inflation in the United States according to a variety of measures.

While these indicators are encouraging, the decline in inflation is the result of economic weakness, rather than substantial productivity growth and monetary restraint, as is the case in Mexico, or the impressive decline in wage growth, as is the case in Canada. In the United States, wages have declined from about 6 percent year-to-year at the end of 1990, to a 3.5 percent annual rate currently. The Employment Cost Index (ECI), a direct quarterly survey of wages and benefits by the Labor Department, shows a less encouraging trend. While the wage increases overall have diminished in line with other measures, virtually all the improvement is due to lower bonuses rather than base pay.

More worrisome is the increase in nonlabor costs, including depreciation, interest, rents and indirect taxes. Nonlabor costs have begun to rise in recent years which produces upward pressure on prices reflected in the stubbornness of the core CPI inflation rate. Indeed, the CPI for important items like autos and apparel have continued to increase throughout the past year and a half, contrasting sharply with the tendency of these prices to weaken during recessions. While this does not suggest that inflation is an immediate concern in the United States, it does indicate that the inflation problem—far from resolved—may reemerge once economic growth resumes.

Inflation and Government Borrowing Concern in Credit Markets

The tendency of long-term interest rates to rise sharply at the hint of economic recovery is wholly consistent with the extraordinary level of government credit market requirements and the modestly improving private demand for credit. As already mentioned, federal deficits are larger relative to GDP than at any time since 1983. Federal borrowing requirements will total $372 billion in 1992 and $332 billion in 1993. This represents 30 to 40 percent of total private savings. Moreover, with the current account stable or improving, there is less foreign capital available to help shoulder the burden of government deficit. Also, the recent search for liquidity by many industrialized countries, particularly Japan, has shrunk the potential international market for U.S. securities—especially given the confiscatory real interest rate differentials that exist between the United States and many other countries.

For all of these reasons, long-term interest rates remain at risk in the United States, and the yield curve is likely to remain very steep. Indeed, without significant improvement in the long-term bond yields, or unless the economy weakens again soon, the Federal Reserve is unlikely to lower short-term interest rates.

Dollar and Financial Markets Are Biggest Risks

Although concerns about the U.S. economy are usually stated in terms of consumer confidence and spending, the biggest risks may be the effect of continued disappointing economic performance on currency and financial markets. As of May, the U.S. dollar has risen about 2.6 percent on a trade-weighted basis since the beginning of 1992. The stronger dollar is based on the expectation that the United States will lead the rest of the industrialized world in economic recovery and interest rates will fall sharply to stimulate economic growth abroad. As time progresses, however, the assumption of a U.S. recovery appears increasingly tenuous. The consumer spending trends, which were so strong in January and February, have tempered considerably in March, and the rise in industrial production remains somewhat muted. On the other hand, German inflation problems have persisted and prompted further increases in interest rates there rather than a decline. Japan has cut interest rates by one-and-a-half percentage points and even here, with lower interest rates and a weak stock market, the yen has strengthened slightly.

Sector Summary

The following is a summary of the outlook for the most important cyclical sectors in the U.S. economy.

Consumer Spending. Cyclical and structural changes have led consumers to adjust current spending and savings plans. Perhaps the most telling indicator of the extent of change is the fact that installment loan payments exceed new credit extended in 1991 for the first time since the late 1950s.

Total consumer spending on durable goods is likely to increase by 3.2 percent in 1992, after declining by 6 percent last year—the lowest increase for a "recovery" period in post-war history. Total spending on nondurables and services is projected to increase by about 1.5 percent in 1992 and only to about 2.3 percent by 1994—the same rate of increase experienced in 1990. The projected weakness in consumer spending is closely tied to the limited growth in incomes over the next few years, since debt is likely to play a less important role.

Housing. Consumer resistance to major purchases extends to housing. While affordability—as measured by the ratio of the average mortgage payment to income—is better than at any time in the past 20 years, new home sales have recovered only modestly. Moreover, multifamily starts, which have made up as much as one-quarter of the housing market in the past, are not likely to recover much at all. As a result, housing starts will remain in a narrow 1.3 to 1.4 million range through at least mid-decade, a far cry from the days of 2.0 to 2.5 million starts.

Autos. Car sales have also been particularly slow to recover due to demographics, price increases, and weak income growth. An increasing number of females in the work force has created more multiple-car families in the past two decades. However, in the past two years, labor force participation rates have stabilized and female participation has actually declined. There is less demographic support for unit growth then, although improved household income may accelerate the shift to high-value automobiles. Moreover, increases in prices have outpaced price increases for other durables. This rise will actually reduce unit purchases unless consumers are willing to raise the share of income allocated to auto purchases. Total car (and light truck) sales then are likely to stay in a range of 12.5 to 13.5 million units through 1994.

Business Investment. Plant and equipment spending will only rise 0.7 percent in 1992, after declining by 6.7 percent last year. Capital spending is likely to grow at about a 4 percent rate over the next two years, almost twice the rate of total economic growth, with much of this growth continuing to be in computers and office equipment, rather than autos and heavy equipment. Investment spending will be broad-based among industries, with a 7.3 percent increase expected in nonmanufacturing. Furthermore, while capital spending in manufacturing appears likely to decline, most of the drop is due to an 11.8 percent expected decline in the petroleum industry. This accounted for 20 percent of all manufacturing investment last year. Two other manufacturing industries, nonelectrical machinery and paper, also indicate large declines. The remaining 13 industries plan a 6.8 percent investment increase in 1992.

Net Exports. The rapid improvement in the trade deficit in recent years is over. Higher domestic demand in the United States, even if modest by historical standards, will draw in increasing imports, while slow growth abroad will reduce export growth. Because the U.S. dollar is likely to weaken, especially against the deutsche mark, exports will grow about 7 percent in 1992 in order to match import growth and keep the trade deficit from widening. Over the next two years, import growth will slow faster than export growth, cutting the trade deficit by about $10 billion.

Canadian Outlook

The Conference Board of Canada

The economic recovery ended in the fourth quarter of 1991 with virtually no growth in early 1992. However, falling employment, a weak profile for U.S. recovery, ongoing structural adjustment in Canada, and a sluggish response in domestic demand to the decline in interest rates will result in quarterly growth rates hovering around only 3 percent in the second half of the year. The result is growth in real GDP of 1.0 percent in 1992—an extremely weak economic performance for the recovery phase of the cycle.

Unfortunately, downside risk continues to exist. The stubbornly high level of both consumer debt and the unemployment rate may result in even less consumer spending than projected in the current outlook. On the other hand, the most recent U.S. data on consumer spending, which if sustained would suggest the prospect of a stronger U.S. recovery than now expected, offers the only glimmer of hope that the Canadian recovery may be stronger than projected.

An important source of weakness in Canada is the consumer. Hurt by falling employment and a steep decline in overall confidence levels, consumer spending declined in late 1991; this would have been much worse had it not been for a sharp decline in the personal savings rate. The economic impact of lower consumer spending was compounded by a largely unexpected steep decline in real net exports in the fourth quarter—due to a sharp decline in exports of motor vehicles and parts to the United States.

Real residential investment spending, however, did increase by 1.5 percent in the fourth quarter in spite of a small decline in housing starts. Unfortunately, this increase was entirely the result of the sharp increase in housing starts in the third quarter.

Business spending was more mixed. Battered by low rates of capacity utilization, weak market demand, and low profit levels, non-energy, non-residential construction spending posted its sixth consecutive quarter decline. However, machinery and equipment investment rose sharply in the fourth quarter, supported in part by business spending for new computer equipment. Growth in this category of investment continued last year despite recession, emphasizing the continuing effort on the part of Canadian business to modernize operations.

Other categories of machinery and equipment investment also rose—although the fourth quarter rise partly represented a return to more normal investment after foreign sales of used aircraft depressed the third quarter level. Finally, non-farm business inventories rose substantially, especially at the retail level where Christmas spending was weak. This suggests new orders will remain depressed in coming months.

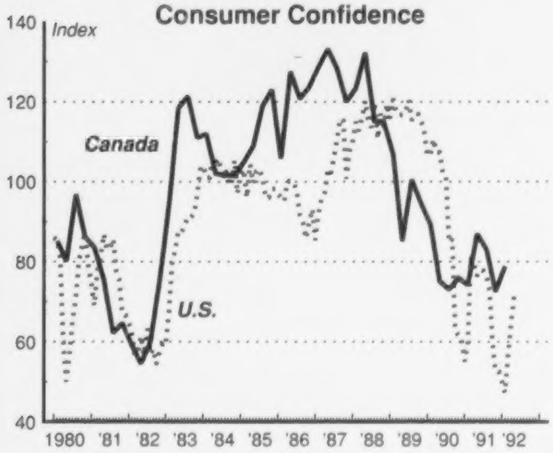
Outlook at a Glance

- Canada's economic recovery ended in the fourth quarter of 1991
- Sustained recovery is unlikely until the end of 1992
- Canadian growth will be subpar this year and next
- Consumer prices will increase by only 2.0 percent in 1992 and 2.6 percent next year
- Weak U.S. growth and falling employment will hamper the pace of recovery
- Canada's unemployment rate will average 11 percent both this year and next
- Efforts to restore Canadian competitiveness will favor capital goods over consumer markets

Stagnation in First Half of 1992

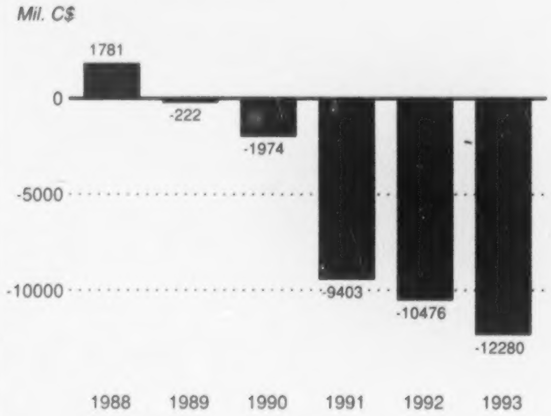
The most recent economic indicators show a grim picture for the first half of the year. Employment continued to decline through the first four months. In particular, with employment falling 110,000 in March

Chart 17: Canadian and U.S. Consumer Confidence



Note: U.S. Consumer Confidence Index (1985 = 100); Canadian Index of Consumer Attitudes (1961 = 100).
Sources: The Conference Board; The Conference Board of Canada.

Chart 18: Canadian Total Provincial Deficit*



* Including municipal government and hospital deficits.
Source: The Conference Board of Canada.

and April, there is not much prospect for improvement over the short term.

In addition, consumer confidence plunged by 10 points in the fourth quarter, reaching levels last seen in the depths of the recession; it remained virtually flat in the first quarter of 1992. Note that Canadian consumer confidence tracked U.S. consumer confidence (see Chart 17). Clearly, the consumer can be expected to exhibit continued weakness in the first half of 1992. On a brighter side, the two sources of strength are the trade sector and domestic housing. Exports are benefiting from a lower currency and somewhat better U.S. performance, while imports are falling. Canadian housing starts will continue to improve through 1992.

The most recent news from the United States suggests the possibility of a quickening in the pace of recovery. Retail sales, housing starts, the purchasing managers' index, and industrial production all posted better than expected gains. As in the U.S., the key for Canada is whether the improving trend in recent months is a precursor to sustained higher growth or only a temporary reaction to recent weakness.

Federal Budget Policy Is Neutral

The current outlook assumes all the measures announced in the recent federal budget, although the net impact of the budget on overall economic activity is essentially zero. The budget continues to place top priority on deficit reduction even though the economy is recovering slowly. Most of the new measures to control the deficit were on the expenditure side, with a further C $1.1 billion withdrawn from the economy this fiscal year as part of the Expenditure Control Plan.

On the revenue side, the Federal budget contained no tax increases for the first time in eight years. Instead, the government introduced a number of tax cuts, including the reduction in the surtax and increases in family and child benefits, which should inject roughly C $1.1 billion into the economy. It also announced a new Registered Retirement Savings Plan (RRSP) Home Buyers' Plan, that will enable potential buyers to remove up to C $20,000 from RRSP accounts in order to purchase a new home, with the money to be repaid over a 15-year period. However, the impact of this measure is expected to be small.

Provincial Budget Policy is Contractionary

The crucial fiscal policy issue in Canada concerns the deteriorating provincial fiscal situation (see Chart 18). The current outlook does include all the provincial budgets. Four provinces, including the larger provinces of Ontario and British Columbia, increased personal income taxes. Expenditures on education and health care were cut back in most provinces. Public servants' salary restraints were reinforced and extended in all provinces.

These tax increases and spending cuts will certainly soften the rebound in economic activity projected this summer, as higher withholdings at source are scheduled for the third quarter. The possibility of further restraint cannot be discounted for 1992. Indeed, the current economic environment continues to take its toll on tax revenue and add to social expenditures.

Interest Rates Highly Volatile

As the economy weakened at the end of 1991, interest rates declined further in early 1992. The Bank rate dropped to 6.6 percent by mid-May. The prime rate followed suit, reaching a low of 7.5 percent. However, the value of the Canadian dollar also declined dramatically from U.S. $0.875 at the beginning of the year to U.S. $0.83 by mid-May. Contributing to the dollar decline were rising interest rates in Europe, a growing realization of the seriousness of the constitutional debate, domestic economic weakness, the prospect of lower interest rates, and deteriorating government deficits, particularly at the provincial level.

While the Canadian dollar is likely to strengthen to C $0.85 next year—because the constitutional crisis should be resolved and European interest rates should be lower—the Bank of Canada is under pressure to support the currency to avoid inflation. Because the current U.S. purchasing power estimates are close to the underlying value of the Canadian dollar, a stable currency near its current level is attainable. The dollar will be tested over the next few months by the latest sign of weakness contained in March and April's job losses.

Lower Dollar Helps Terms of Trade

Ignoring the impact on inflation and interest rates, a lower Canadian dollar in itself should help economic growth, both through increasing exports and increasing profits on investment in those industries with products priced in U.S. dollars. The lags are long, however, and little positive impact on growth from the lower dollar is expected until 1993.

Looking ahead, the outlook assumes the most recent bout of interest rate increases should be sufficient to hold the dollar at current levels. With no further change expected in U.S. interest rates this year, and given a very weak Canadian recovery, interest rates are expected to hold for the remainder of 1992, and then rise in 1993 as the recovery progresses.

Inflation is Down, but It Doesn't Appear to Help

The slowdown in world growth generally has caused sustained deflation in many raw materials and industry product prices. Prices for steel, pulp, paper and mine products have been especially hard hit. However, the most recent price data suggest the bottom for many of these commodity prices has been reached.

As the recovery takes hold, a general firming in product prices is expected to put some underlying pressure on inflation in the second half of 1992. In addition, the devaluation of the Canadian dollar will add about 0.7 percentage points to the inflation rate, as well as lift commodity prices—in Canadian dollar terms—increasing profitability in the primary sector. Still, the extremely weak state of consumer demand has led to a dramatic slowing in CPI inflation in the last half of 1991, a slowing expected to continue this year. Overall, CPI inflation is now forecast to average only 2.0 percent in 1992.

Sector Summary

The following is a brief summary of some of the most important sectors in Canada.

Housing. After peaking at 198,000 units in October, housing starts declined to 143,000 units in January, prompting fears of a renewed recession. This spurred further housing incentive measures from the Fed, including a reduction in the down-payment required on Canada Mortgage and Housing Corporation (CMHC) insured mortgages and the RRSP Home Buyers Plan. Fortunately, housing starts have recovered somewhat to 159,000 units in February, suggesting that the drop was temporary. Housing starts averaged 153,000 units in the first quarter of 1992 as a whole. They reached 160,000 units last April.

Despite lower mortgage rates, however, household incomes and confidence are not robust enough to support a strong, sustained recovery in this sector. Aside from a possible surge as potential buyers jump into the market—now that rates are perceived to have bottomed out— further growth in starts is expected to be very slow over the course of 1992 and 1993. Residential construction investment will grow by 8.6 percent in 1992, making it the only domestic bright light in an otherwise dreary economy.

Business Investment. Surveys of investment intentions indicate that the outlook for non-residential construction spending was weaker, while the outlook for machinery and equipment investment improved. There is little implied change to the overall investment outlook.

Indeed, non-energy related business construction is now forecast to decline by close to 12.0 percent this year. The generally weak nature of the recovery, very low rates of capacity utilization and, most important, the dismal level of corporate profits now preclude any recovery in non-energy, non-residential construction investment until 1993. Given sluggish recovery likely next year, this category of investment is expected to grow by only 3.8 percent in 1993, which is extremely weak compared with previous cycles.

Energy Investment. The outlook for energy investment this year, as indicated by various investment surveys, has also deteriorated, mainly because of the delays to the Hibernia project, an oil drilling project off the coast of Newfoundland, and a weaker drilling profile. Overall, real energy investment is expected to grow by 2.5 percent this year, before declining by 7.5 percent in 1993.

Non-Energy Equipment Investment. With growth expected at 1.3 percent this year and 6.2 percent in 1993, non-energy machinery and equipment investment is a relatively strong sector in the Canadian economy. Much of the strength comes from ongoing structural adjustment by manufacturing to improve competitiveness. This will be achieved in part through labor saving equipment. Unfortunately, a large share of the investment demand leaks abroad through increased imports.

Net Exports. The overall weakness in the U.S. economy in 1992 will hold growth in Canadian exports to 2.9 percent this year. One area of relative strength is U.S. housing starts, which should fuel a recovery in Canadian lumber exports. Canadian auto and auto parts exports will also benefit from the surge of U.S. consumer demand in the first quarter. Natural gas and electricity represent other sources of export strength this year.

There will be little improvement in real net exports over the course of the next two years, however, as import growth keeps pace with exports. As mentioned earlier, the major culprit is machinery and equipment imports and continued market share penetration by offshore auto producers.

Consumer Sector. The behavior of the consumer continues to be the most problematic aspect of the outlook. Recent revisions to the labor income data by Statistics Canada (the official statistical agency of Canada) have changed the savings rate profile substantially. Instead of holding flat at close to 11 percent throughout 1991, savings rates now appear to have declined steadily from 10.6 percent in the first quarter of last year, to 9.2 percent by the fourth quarter. Households appear to be responding to high unemployment and weak income growth by trying to maintain living standards through lower savings. This new data clearly suggest weaker household spending; overall consumer spending this year is expected to remain virtually flat.

A substantial and broad-based recovery in consumer spending will not occur until export growth to the United States picks up—and this is not expected until the second half of 1992 at the earliest. In addition, given the extremely sluggish employment outlook and an unemployment rate which remains close to 11 percent throughout the near-term horizon, consumer spending is expected to increase only 3.1 percent next year, in spite of a further lowering in the savings rate.

Mexican Outlook

Centro de Estudios Economicos del Sector Privado, A.C. (CEESP)

Outlook at a Glance

- Mexican growth continues at high rates, although performance would undoubtedly be even better without recession and/or economic weakness in the United States and Canada
- Growth in Mexico is dominated by business investment; the consumer sector also continues to grow rapidly
- Inflation remains a concern and, though improved, is likely to come in higher than projected by the government in 1992
- Market pressures will favor peso appreciation, despite official policy to bring the value of the peso down
- Profitability will continue to be a major challenge for Mexican business
- Despite focus on manufacturing because of trade talks, telecommunications and services are fastest growing sectors

According to preliminary data, Mexican GDP increased by 4.1 percent in 1991, double the rate of population growth for the third consecutive year. At the same time, inflation fell by more than 11 percentage points, from 29.9 percent in 1990, to 18.8 percent in 1991 compared with the original target of 14 percent for the year.

In March 1992, the Mexican government released its final estimate of national income for 1991, for which only partial detail is available. These numbers show GDP grew 3.6 percent in 1991 compared with 4.1 percent in the preliminary data. This revision reflects the weak U.S. economy and a soft oil market which have hurt the Mexican economy. Nonetheless, this would still make 1991 growth the second highest in the decade. However, final official estimates for aggregate demand, investment, production, etc., have not been released so therefore the following discussion is based on the preliminary data.

The economy's growth was sustained by private spending, both business investment and consumer spending, which rose 13.8 percent and 5.0 percent, respectively, and non-oil exports, which grew at a 6 percent annual rate. Growth was widespread in both manufacturing and services. Capital goods production grew 13.7 percent, while consumer durables and intermediate goods rose by 6.7 percent and 3.8 percent, respectively.

The most dynamic manufacturing industries were automobiles, metallic products (primarily steel), and machinery and equipment. However, other industries with heavy import competition (e.g., chemicals and paper and pulp) showed only modest production gains. Mining remained stagnant, as the slowdown in the world's leading economies depressed mineral prices. Services such as transportation, communications and financial services benefited from the rise in purchasing power and were among the most rapidly growing sectors.

Transportation benefited both from strong investment spending in modernization and from the overall level of economic activity. Agriculture also experienced a mild recovery (up 2.6 percent for the year), mainly as a result of good weather and credit availability. Table 4 (page 40) shows Mexican GDP by sector based on the preliminary data.

The economy's growth, however, was not uniform throughout the year. Growth was very strong in the first half (rising at an annual rate of over 5 percent) but slowed in the second half, a delayed reaction to the U.S. and Canadian recessions and a consequence of credit tightening by the Bank of Mexico.

Public sector finances continued their impressive improvement, with the federal deficit for 1991 around 1.5 percent of GDP. The start of the privatization of com-

Table 4: Mexico's Gross Domestic Product By Sector: 1991

(Annual Growth)

Total	4.1
Agriculture, Livestock, Fisheries and Forestry	1.2
Mining	0.8
Manufacturing Industry	3.4
Construction	1.7
Electricity	4.3
Commerce, Restaurants and Hotels	6.0
Transportation and Communication	6.6
Financial Services, Insurance and Real Estate	4.7
Community, Social and Personal Service	3.3

Sources: CEESP with data from INEGI.

mercial banks and other important public enterprises, such as TELMEX (the telephone company), provided additional revenue to the government (not included in the financial deficit result), most of which was used to redeem domestic public debt in September 1991.

Moreover, the huge inflow of foreign investment, both direct investment in Mexican business and foreign investment in Mexican stocks and bonds, as well as capital repatriation by Mexican nationals accelerated. This allowed Mexico not only to finance its huge trade deficit (over $12 billion), but also to increase foreign exchange reserves.

The prospects for 1992 as a whole are similar to 1991. Rapid economic growth will fuel employment and income gains, while at the same time inflation remains a key concern. With a tight fiscal discipline and cautious monetary policy, the inflation rate might approach single-digit levels this year. Nonetheless, the continued inflow of capital from abroad makes it difficult to reduce inflation below the 11-13 percent level because it pushes interest rates down and adds liquidity to the fast growing Mexican economy which is difficult for the central bank to control. Moreover, economic growth above 4 percent and sharply rising imports creates the potential for a classic demand-based inflation.

Because of the extraordinary foreign investment, however, Mexico can both finance an increasing trade deficit and increase foreign exchange reserves. Moreover, the public sector which is expected to show a surplus of almost 1 percent of GDP, will also contribute important resources for new private investment. The social security system initiated this year will create a new pension fund scheme to be privately administered by financial institutions providing a large pool of long-term capital to finance economic development.

Among the key sectors, private investment is expected to grow the most rapidly because firms are modernizing in anticipation of NAFTA. Public investment in basic infrastructure and development of rural areas is expected to rise 5 percent in 1992.

Both income and employment will once again support large gains in consumer spending as will a further drop in domestic interest rates. Moreover, in contrast to the U.S., the government sector will be a source of savings for private investment because of the budget surplus.

Risks in the Outlook

Despite the breadth of Mexican economic success, there are a number of concerns. First, because of the surge in foreign capital into Mexico, there is a risk of overheating the economy.

The Bank of Mexico has to balance short-and long-term economic objectives between near-term economic growth and long-term inflation and economic stability. Ironically, since the source of the dynamism is private spending rather than public spending, the pace is more difficult to control from a public policy perspective.

Second, it is unlikely that a North American free trade agreement will be signed and approved during 1992. One consequence of a delay might be lower foreign capital inflows. This would mean slower growth, or a widening trade deficit that would have to be financed, in part, by using foreign exchange reserves.

Third, slower growth than projected in the United States could reduce Mexican exports there as well as U.S. investment in Mexico—both of which would dampen Mexican economic performance.

Fourth, from the point of view of Mexican firms, rapid growth in foreign investment is a mixed blessing. The presence of foreign companies increases competition in the Mexican market not only through imported products, but also through the establishment of subsidiaries, agencies, franchises and the like that reduce margins and market share for Mexican firms. The consequence is lower domestic profits for Mexican firms. Indeed, nearly all the increased domestic growth generated in Mexico in recent years has benefited foreign producers through higher Mexican imports (see Chart 19).

A fifth and related concern is the rapid rise in real wages for the average Mexican worker. While the absolute gap between Mexican and Canadian wage rates is wide, much of the difference is related to the large differences in worker productivity among the three countries. When adjusted for productivity, Mexican labor costs are much closer to those in its northern neighbors and, therefore, rapid wage increases could cut deeply into Mexico's competitive advantage.

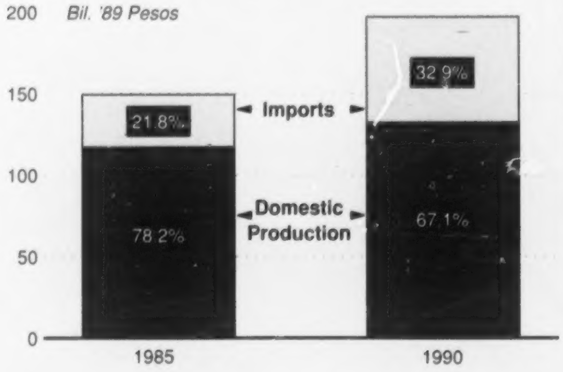
Inflation Improving; but Remains a Risk

Inflation has continued to improve steadily and rose 18.8 percent last year compared with over 50 percent in 1988. Still, money growth is too high to assure lower inflation and higher Mexican unit labor costs, rising service sector prices, and rising international prices for imported goods all serve to keep inflation high. As a result, the inflation rate of 9.7 percent in the official forecast for 1992 will be hard to achieve without a significant "cooling down" of the economy; it is more likely to average 12.7 percent for the year. While this is an improvement, it is still a long way from the low inflation rates of Mexico's principal trading partners.

Employment Gains Substantial

Employment, as measured by the number of workers registered at the Social Security Institute (IMSS), increased last year at an annual rate of 5.0 percent. This is equivalent to 480,000 new jobs. The greatest increases were in construction services (6.0 percent), and manufacturing (3.8 percent). The unemployment rate in what is known as the "open" sector fell to 2.6 percent in the country's main metropolitan areas. ("Open employment" is defined by INEGI, the Mexican statistical agency, as "formal unemployment" which excludes underemployment, defined as people that were able to work for at least one week per month.)

Chart 19: Manufacturing Sector: Share of Imports in Total Supply



Total Increase 1985-90: Production 13.4%, Imports 99.3%

Source: CEESP, with data from Banxico.

Despite strong employment growth, lower inflation will help moderate union demands for higher wages. Real wages are likely to rise 2 to 3 percent for the year compared with 9 percent in 1989, 2.8 percent in 1990, and 4.9 percent in 1991. Even with the solid gains of recent years, Mexico's economic decline during the mid-1980s was so severe that the purchasing power of the average workers' wage is still 15 percent below the 1980 level.

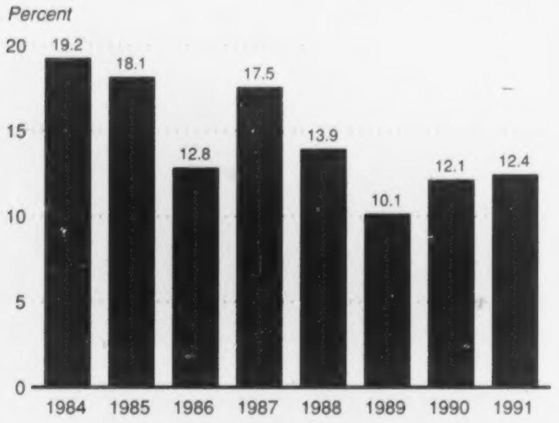
Excess Liquidity Driving Rates Down

During the past two years, monetary policy has been driven by the need to offset the extraordinary capital inflow from abroad. This effort, however, has been only partly successful. Total foreign investment outstanding in the Mexican capital market reached $18 billion by the end of 1991, more than triple the 1990 level. Also, capital repatriation from Mexican nationals amounted to $2.9 billion. Total capital repatriated in the last two years was $5.9 billion; this represented 62.7 percent of the current account deficit in 1990 and 26.4 percent in 1991.

A lower public sector deficit in 1991 has also added liquidity by minimizing public sector drain on capital markets, freeing up substantial resources for private sector investment and allowing nominal and real interest rates to come down.

Improved inflation expectations and large capital inflows have benefited financial markets, keeping the yield curve flat for the main instruments, such as CETES-28 day (T-Bills) and AJUSTABONOS (inflation-linked bonds). Since February, foreign investment in Mexican bonds was so great as to inflate prices and reduce long-term interest rates below central bank determined short-term interest rates. The clear implication is that the Mexican monetary authorities have chosen to keep short-term interest rates higher than would appear justified given long-term optimism about Mexican infla-

Chart 20: Mexico: Net Corporate Earnings



Note: Weighted average from listed companies at the Mexican Stock Market. 1991 includes third-quarter results.
Source: CEESP, with data from the Mexican Stock Exchange.

tion. Indeed, the strength in the Mexican bond market contrasts strikingly with the United States where long-term interest rates have remained stubbornly high.

Foreign Exchange Reserves and Government Finances Improving

Foreign reserves increased significantly during 1991, closing the year at approximately $21 billion, up from $10.2 billion a year earlier. In 1991, the remaining exchange controls (essentially registry requirements) as well as the dual-exchange rate mechanism were formally abolished, leaving only the free-market rate. Finally, the privatization of TELMEX and the beginning of the commercial banks' privatization, increased government revenues by $8 billion. In September, the equivalent of almost $6 billion of these revenues were used for an anticipated redemption of domestic public debt. Public debt as a share of GDP has declined from 32.3 percent in 1987 to a projected 12.5 percent in 1992.

Corporate Finances Improving

The improvement in corporate finances has paralleled the improvement in the public sector. For example, the leverage ratio (total liabilities to total assets) has come down from 46.5 percent in 1986, to 36.8 percent in 1991. Moreover, the losses in net operating profits in the second half of the 1980s, which were the result of the sharp decrease in import trade barriers, now appear to have ended. Corporate profits, more or less stable for the last three years, have also improved somewhat recently (see Chart 20), and Mexican companies have returned to international capital markets to finance modernization. Last year they obtained $2 billion in foreign credit.

Nonetheless, as trade barriers continue to come down, the intensely competitive nature of the Mexican market and the longer-term prospect of peso appreciation represents a major risk for the growth and profitability of Mexican business.

Trade Deficit Deteriorates

In 1991, the trade deficit reached an estimated $11.2 billion as a result of a 23 percent increase in imports and only a 0.8 percent rise in exports. However, non-oil exports, which include intermediate and manufactured goods exports, grew by 3 percent despite a weak demand—especially from the United States. In 1991, the current account deficit totaled $13.3 billion.

Since 1982, non-oil exports have more than tripled to $19 billion, now representing 70 percent of total exports. Also, the weighted average duty is only slightly above 10 percent; whereas in 1982 it was 16.1 percent.

Automobiles and auto parts—representing 18 percent of total exports—are by far the most rapidly growing manufacturing exports. These are followed by chemical products (6 percent), food and beverages (4 percent), and textiles (3 percent).

Imports, on the other hand, mirror the changing structure of the domestic economy, especially the strong growth in investment over the last few years. Consumption goods contribute only 14 percent of imports, while intermediate manufactured goods and capital goods make up the remaining 64 percent and 22 percent respectively. Intermediate and capital goods imports grew 25 percent last year.

Maquiladora Growth Stalls

After years of remarkable growth, the Maquiladora industry has slowed as a consequence of a weak U.S. economy. Last year, net revenues grew only 13.7 percent, compared with 30 percent in 1990 and 46 percent in 1989. Employment creation, however, vanished completely in 1991 and real wages actually dropped by 3.3 percent as U.S. demand eased.

Sector Summary

The following is a brief summary of some of the most important sectors in Mexico.

Autos. The auto industry has been one of the most dynamic sectors in the Mexican economy. It is the largest single industry in terms of foreign exchange earnings. The recovery of the domestic market and reduced interest rates have helped sustain the expansion of this industry.

In 1991, the auto industry achieved record production and sales levels. The previous record was set in 1981, an oil-boom year. In the 1988-91 period,

Table 5: Top Commercial Banks in North America — Total Assets

(Millions of U.S. Dollars)

United States as of December 1991		Canada as of October 1990		Mexico as of December 1990	
Citicorp	216,922	Royal Bank of Canada	107,842	Banamex	22,416
Chemical Banking	138,930	Canadian Imperial Bank	97,788	Bancomer	18,512
BankAmerica	115,509	Bank of Montreal	74,816	Serfin	15,930
NationsBank	110,319	Bank of Nova Scotia	74,693	Comermex	6,009
J.P. Morgan	103,468	Toronto-Dominion Bank	57,288	Internacional	5,220

Sources: *Fortune*, August 26, 1991; *The Banker*, August 1991; *BusinessWeek*, April 27, 1992.

domestic sales increased by 23 percent per year, while output rose at 22 percent in the same period. Total vehicle production in 1991 was close to 1 million units (952,000), out of which two-thirds were for the domestic market and the remaining for exports—mostly to the United States, but also increasingly to Latin America. The total value of the industry's exports (i.e., finished vehicles plus autoparts) amounted to $5.5 billion in 1991, 84 percent above the 1987 level despite the U.S. recession. Last year, import limits on luxury autos were eased. Manufacturers can now import luxury autos and auto parts based on the level of their auto exports up to 15 percent of total domestic auto purchases. Although the industry's imports have increased substantially, the great majority of the imports are auto parts.

Currently, the industry operates under the rules laid out in the Mexican Auto Pact. These require that a minimum of 26 percent of the value-added to the product be Mexican. This has fostered the growth of a domestic auto parts industry, usually consisting of joint ventures between U.S. and Mexican firms. The domestic content requirement is a key issue in NAFTA talks, especially on two specific points: the degree of access and the domestic source requirements for producers outside the region, and the extent to which such a scheme is compatible with the United States (i.e., the Canada Auto Pact within the U.S.-Canadian Free Trade Agreement).

Tourism. Long an important source of employment and foreign exchange, tourism is growing rapidly. In 1991, 6.4 million people visited Mexico or 1.5 percent of the world's tourists. Overall, the tourist trade surplus has exceeded $1.4 billion in each of the last four years.

The deregulation of the Mexican airline industry has allowed for a significant increase in charter flights and multiplied route rights for Mexican and foreign carriers. Mexican bus and rail traffic has also been deregulated and facilities granted for U.S. carriers to operate in Mexico. The hotel industry is one of the fastest growing tourist industries, increasing by 12 percent to 344,000 rooms in the last four years.

Financial Services. The privatization of commercial banks, begun in 1991, has led to the consolidation and integration of banks and other intermediaries into "financial groups." The intention is to create institutions capable of competing in the North American market. More than half of the commercial banks have been successfully privatized.

Many of the trends that have marked the evolution of the financial services industry in the United States are evident in Mexico. From 1982 to 1990, the share of total financial transactions handled by commercial banks, for example, fell from over 50 percent to about 30 percent. This compares to about 25 percent for U.S. banks. Mexican brokerage houses, on the other hand, increased their share from 2 to 17 percent in contrast to the U.S. market where mutual funds and pension funds account for 36 percent of all financial transactions. However, in Mexico, since commercial banks are the core of "financial groups," they are likely to retain a dominant role within the financial system. Insurance companies are the least developed segment of the financial intermediaries, basically because they have been highly regulated for many years.

The extent of financial intermediation as measured by the ratio of M4 (the broadest measure of liquidity in Mexico which includes all banking and financial instruments) to GDP is still relatively low—less than 40 percent. Mexico's largest bank is about one-tenth the size of the largest U.S. bank. Nonetheless, as changes enhance an environment of financial stability, such as lower inflation, privatization and deregulation, the scope for growth in Mexico's financial services industry is significant (see Table 5).

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The Conference Board

Report Number 1006

Small Group Incentives: Goal-Based Pay

Case studies show:

- *small group incentives popular with manufacturers, banks*
- *production and financial criteria most often used to evaluate group performance*
- *variety of techniques used to communicate plan to participants*
- *employee involvement programs support small group incentives*

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Small Group Incentives: Goal-Based Pay

by Paige Berson-Besthoff and Charles Peck

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Method

This report is based on information gathered in connection with an earlier Conference Board study, *Variable Pay: New Performance Rewards*, Research Bulletin No. 246, 1990. In early 1992, data on small group incentives from the 1990 study were updated and expanded by a questionnaire and telephone interviews with survey participants. Additional information was drawn from current literature. Also used is anecdotal material from numerous sources, including conversations with company representatives and consultants, conference presentations, and articles in the business press.

From the President

As prior Conference Board studies have revealed, U.S. corporations are turning more and more to performance-based or variable pay plans. These plans strive to raise employee productivity and link pay directly to performance.

One such plan is the small group incentive. Rewarding employee teams for achieving meaningful, quantifiable goals allows them to share in the success of the company. Additional benefits are increased cooperation among employees, greater attention to customer satisfaction, and an enhanced understanding of the organization's objectives.

This report, part of the Board's ongoing research on variable pay systems, provides an overview of small group incentives as well as examples of practices. A related study on noncash award programs is also available from The Conference Board.

The Conference Board is grateful to those who participated in the study, whose experience and expertise made this report possible.

PRESTON TOWNLEY
President and CEO

Executive Summary

The ongoing effort by U.S. corporations to raise productivity, control costs and effectively position themselves in global markets has accelerated interest in performance-based pay plans. These plans, generically called "variable pay," include group incentives such as profit sharing, gainsharing and, the subject of this study, small group incentives (SGIs).

SGIs gather employees into relatively autonomous groups to accomplish a specific, preferably measurable, task. In the ideal arrangement, the group is given the information and resources needed to reach the goal, their progress is reviewed during the performance period, and they are given the opportunity to provide feedback to management. At the end of the performance cycle, the undertaking is evaluated by management and, if successful, an incentive is paid. The incentive is usually a uniform percent of base pay paid in cash to each member of the group.

The tasks of individual SGIs are as varied as the types of employees included and the kinds of organizations involved. The SGIs studied in connection with this report have goals ranging from improving collection of bank card balances to producing more inches of silicon wafers. This report examines the specific criteria of the different plans used to evaluate the group's success in accomplishing its task.

The unifying concept of these plans is the group working as a team to achieve a realistic, measurable, significant goal. According to this study, the reported objectives of the SGIs fall into the following categories: cultural, financial, productivity/quality, compensation and task specific objectives.

No matter how well designed, an SGI can only be successful in a culture receptive to such plans.. Compensation systems can reinforce or direct certain behaviors but they cannot in themselves generate these behaviors. In addition, there is often an uneasy relationship between group and individual incentives that reflects the tension between team play and individual reward—which must be addressed when considering an SGI.

The report shows a proportionately high use of SGIs by manufacturers and banks. Manufacturers have the longest tradition in group incentives, going back to the origin of group gainsharing plans in the 1930s. Banks have proven very innovative in adapting many of their activities to group projects. No doubt reflecting this industry bias, production and financial criteria for evaluating group performance are most often reported by survey participants.

The median annual payment reported from SGIs is 4 percent of base wages and/or salaries. The actual range of payments reported, however, is quite wide; the lowest is under one-half of 1 percent; the highest is 25 percent of base pay.

Ancillary to the actual plans, the surveyed organizations reported a variety of communication techniques for explaining the plan and keeping participants informed of their progress toward the goal. The most frequently used communication method is periodic meetings of the group with their manager, where a relatively informal, two-way exchange is encouraged.

The future outlook is for continued use of SGIs in manufacturing and banking. Deregulation in the utilities industry will further the use of incentives generally, including SGIs. While the labor-intensive nature of the service industry suggests fertile ground for SGIs, there is some difficulty with establishing concrete measures. However, more experience with incentives will probably alleviate these difficulties.

Introduction

Over the past decade, there has been growing interest in a form of employee compensation called either "non-traditional" or "variable" pay. Variable pay is defined here as compensation, other than base wages or salaries, where payment fluctuates according to a standard. The standard may be a predetermined formula, as in the case of productivity gainsharing plans. It may be the achievement of specific goals as in the cases of group or individual incentives. The standard may be the performance of an individual over a specified period of time (as in the case of the merit bonus), or it may be the performance of the entire organization (as in the case of current profit sharing). The programs usually considered as variable pay plans are as follows:

- *Current Profit Sharing*: Uniform payment to all or most employees based on organizational profitability.
- *Exception Restricted Stock/Stock Options*: Grants of stock subject to restrictions or stock option grants to employees ordinarily not eligible for such awards.
- *Gainsharing*: Plans designed to measure the productivity of a unit or organization and to share the value of productivity gains uniformly with all participating employees. Includes Scanlon, Rucker, Improshare and customized plans.
- *Individual Incentive*: Payment based on measured individual performance, for example, piece work systems.
- *Merit Bonus*: Payment based on individual performance given in lieu of or in addition to a merit increase and never added to base salary.
- *Organization-wide Bonus*: Uniform payment to all or most employees, usually at fiscal year end.
- *Small Group Incentive*: Uniform award to all members of a group, based on their achievement of a predetermined objective.

This list covers those plans structured for employees who have traditionally been ineligible for variable pay—nonmanagerial, nonsales salaried and hourly employees. Those programs designed specifically for top executives and field sales personnel, the two traditional recipients of variable pay, are not included.

Although variable pay arrangements have not been widely used in the past, especially by larger companies, the concept is not new. For example, productivity gainsharing originated during the Depression when Joseph Scanlon, a steelworker, devised the first gainsharing plan to raise worker productivity and save a failing steel mill. Profit sharing allegedly has even deeper roots; a version of profit sharing supposedly existed among the guilds of medieval France.

What *is* new is the level of interest shown in these plans. Historically, variable pay systems for employees other than top executives or field sales personnel were most often found in smaller companies. Since the cash reserves and profit margins of small companies are often relatively low, they gravitate to compensation devices closely tied to the ability to pay (for example, current profit sharing, based on organization profitability, or gainsharing, based on productivity improvement) rather than relying exclusively on fixed wages and salaries.

When the prosperity of the 1960s gave way to the inflation of the late '70s and the economic uncertainties plaguing the '80s and early '90s, companies, concerned with costs, flagging productivity, and foreign competition, were forced to take a very critical look at their compensation systems. This look revealed that standard pay practices, especially the "merit" increase for salaried employees, were not based on realistic evaluations of individual performance. In fact, the lauded pay-for-performance concept was more honored in the breach than in the observance. Merit increases were, all too often simply "general" or "across-the-board" pay adjustments where almost everybody got a raise, regardless of performance. The result was that top performers got less than they deserved, and poor performers got more. This widespread practice was extremely expensive and did nothing to encourage the productivity improvement U.S. companies desperately needed to compete in increasingly global markets.

Variable pay, with its performance measures, began to look more and more attractive to both large and small companies. According to a 1987 American Productivity and Quality Center study: "More gain sharing, pay-for-knowledge, small group incentives, lump-sum bonuses and two-tier plans have been adopted in the last five years than in all of the prior 20 years."[1]

The present study is part of an ongoing stream of research by The Conference Board to respond to this interest in variable pay systems. The original 1990 study, *Variable Pay: New Performance Rewards*, reported on the prevalence of variable pay plans and company practices regarding the different types of plans.[2] *Gainsharing for Productivity*, 1991, focused on one type of variable pay system, productivity gainsharing.[3] The present report deals with another form, small group incentives (SGIs), sometimes called "team incentives."

Organizations have espoused the concept of "group" or "team" work from time immemorial. In the sports vernacular popular in the modern, post-industrial corporation, calling someone a "team player" is an accolade, while saying someone is "not a team player" is pejorative. On the plant level, there is a considerable body of experience with work groups engaged in common or similar tasks, which operate with varying degrees of autonomy. In the company's offices, it is quite customary to form small groups, usually called task forces, to address all sorts of issues from the implementation of a total quality program to recommending a tuition refund policy. And, in a spontaneous fashion, while performing their regular duties, employees form "natural" groups. For example, a human resource employee responsible for devising a "fast-track program" for engineers works with the engineering department head and with a programmer from the EDP department, who develops a "fast track" computer model. Hence, a natural group is formed.

On the other hand, measuring a group's success in meeting its goal and making (or withholding) an incentive payment on the basis of that measurement has not been a feature of group projects. In fact, one criticism of traditional salary systems is that they actually work against the group enterprise. For example, under a merit increase program, employees are placed in the position of competing against one another for a limited pool of merit dollars.

The state of business conditions in particular has no doubt contributed to the shift from a generally stated belief in the value of teamwork to the systematic creation, measurement and compensation of small groups. As currently practiced, the group can be either permanent, renewable or assembled for the duration of the project. Permanent groups are usually involved in an ongoing activity. An example of such a group, reported by one participating company, is an interdepartmental team involved in customer service whose goal is to achieve a high degree of customer satisfaction. Customer satisfaction is continually and concretely measured by a periodic survey of customers and through monitoring and analysis of the number and types of complaints received. The payment of the incentive to the group members is directly linked to these criteria.

A renewable plan also involves an ongoing activity; however, its effectiveness is periodically (usually annually) audited. For example, a participant measures group performance on the basis of financial criteria and quality of service based on a customer survey. In contrast to the first example, this plan is reviewed annually and may be renewed without change, modified or discontinued. A typical life-of-project plan, reported by a third participant, involved a group assembled to develop and implement a new manufacturing process. Management's final acceptance of the proposed process, submitted by the group within a specific time limit, was the standard for evaluating the success of the project. Once the project was concluded, the group was disbanded.

Whether the group is permanent, renewable, or for the duration of a project, certain basic concepts are involved. In an article in the *Sloan Management Review*, Edward J. Ost listed five basic premises behind SGIs:

- The performance goals can be achieved only by teamwork.
- Payment of the incentive is conditional on meeting the goal.
- The participants can relate the payment to their contributions.
- The payment is perceived as equitable.
- The behaviors required and the rewards offered clearly delineate and support "good" performance.[4]

The following study examines the practices of 29 organizations that currently use SGIs. These include those with permanent programs, renewable ones and/or organizations that form small groups for special projects. Reported on are: plan objectives; implementation; characteristics of the plans—including groups covered, performance criteria, life of plans, and payment of the incentive; and communication/involvement systems. Other sections present case studies of plans presently in use, examine the degree of success achieved by the plans and look at the probable future of the SGI concept.

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[1] Carla O'Dell, *People, Performance, and Pay*, Houston, Texas: American Productivity Center, 1987, p. 9.

[2] Charles Peck, *Variable Pay: New Performance Rewards*, The Conference Board, Research Bulletin No. 246, 1990.

[3] Charles Peck, *Gainsharing for Productivity*, The Conference Board, Report No. 967, 1991.

[4] Edward J. Ost, "Team-Based Pay: New Wave Strategic Incentives," *Sloan Management Review*, Spring 1990.

Small Group Incentive Considerations

Objectives of Small Group Incentives

The survey participants were asked to state the objectives of their SGIs. Before examining these statements, two concepts involved in SGIs that are not always separable should be noted: the *objectives* that the organization wishes to achieve through its SGI, and the *criteria* used to measure the group's performance in pursuit of the objectives. As a general rule, the criteria are the *specific* means of achieving the more *general* objective.

In some cases, however, the objectives cannot be clearly distinguished from the evaluative criteria—most often when the group is a temporary one, formed to accomplish a specific task. The objective and the criteria may be the same: successful completion of the task. More often, the objectives describe broad business—goals—such as employee behavior patterns, organizational culture, or organizational financial performance—while the criteria are specific to the group's assigned task.

The reported objectives of SGIs are grouped in the following categories:

- cultural objectives, usually relating the characteristics of the organization as a whole;
- financial objectives;
- productivity/quality objectives;
- compensation objectives; and
- task-specific objectives.

Participants' stated objectives are listed under these five categories according to the number of times each was mentioned (see Table 1). These objectives are supported in most small group incentives by specific criteria for evaluating the group's performance. The objectives are the raison d'tre of the plan; the measurement criteria are the implementation of the objectives.

For example, a reported production objective is to focus employee attention on value-added work. Hence, a company with a gainsharing-type SGI makes value-added the end-product of the formula:

Value Added = Output Minus Input.

In one such manufacturing company, the 15-person skilled trade group was measured according to a formula, where the cost of their labor represented the input, the value of the product was the output, and value-added was the difference between the two.

Another example of a general objective translated into a measurement criterion is "relating pay to performance." Here the broad objective is actualized in a performance measure that directly determines the size of the incentive. A primary metals company, for example, uses a formula relating the dollar amount of the incentive to performance criteria consisting of measures of hours, production volume, and a "quality trend index."

The specificity of the measurements used in SGIs varies according to the individual plan. While some, particularly gainsharing arrangements, have rigid, numeric measures, others use more subjective assessments of the group's performance. Of course, the achievement of some of the qualitative objectives such as "teamwork" can only be indirectly measured. If, for example, a gainsharing-type SGI pays out, there must be implicit, if not measurable, teamwork.

In general, the relation between the objectives and the measurement criteria must be carefully structured, so employees act in a way that will meet the criteria for the incentive payment and contribute to the achievement of the objective(s). (See "Effectiveness of Small Group Incentives" pp. 23-26, for an examination of the success participants experienced in achieving their major objectives.)

Implementing Small Group Incentives

Cultural Readiness

Implementing incentive systems in general and small group incentives in particular sometimes fails, because they are imposed on a culture that is not receptive to them. Failure often follows from either or both of two misconceptions.

Table 1: Objectives of Small Group Incentives

(1) *Cultural Objectives*	*Times Mentioned*
Promote teamwork	16
Focus group on predetermined goal	6
Reduce turnover	2
Increase employee empowerment/involvement	1
Motivate employees	1
Change the organizational culture	1
Increase efficiency	1
Motivate employees to act as owners	1
(2) *Financial Objectives*	*Times Mentioned*
Increase profits	6
Reduce costs	4
Increase sales	3
Increase return to shareholders	2
Meet budgets	1
(3) *Productivity/Quality Objectives*	*Times Mentioned*
Increase productivity generally	9
Improve quality generally	3
Improve productivity to increase profits	2
Provide measures for productivity/ quality improvement	2
(4) *Compensation Objectives*	*Times Mentioned*
Relate pay to performance	5
Introduce variable component to pay package	3
Link rewards to team performance	2
Substitute incentive for base pay increase	1
Replace individual incentives with group incentives	1
(5) *Task-Specific Objectives*	*Times Mentioned*
Focus employees on output/ scheduling	2
Improve safety	1
Focus employees on value-added work	1
Improve through-put	1

Note: Respondents could report multiple objectives.
N=29

The first is the imitative or "knee jerk" adoption of an incentive system. This occurs when Company A unreflectively imitates the practice of Company B with which it compares itself, assuming that if a competitor has an SGI so should A, irrespective of whether an SGI would be suitable for its particular culture.

The second misconception is the fallacy of confusing the tail with the dog. An incentive compensation system can reinforce or direct certain behaviors but cannot in itself generate them. The underlying culture is the genesis of employee behavior patterns, which can then be enhanced and directed by the incentive system. If the culture is not already receptive, it must be made so. This requires a veritable "sea change," and should not be sought without considerable forethought and the willingness to spend much time and effort. These problems illustrate the often stated and frequently ignored dictum that compensation systems should be instruments for carrying out a coherent business strategy but cannot originate it.

The characteristics of a culture appropriate for SGIs are listed below. While an organization does not have to have each and every one for a successful program, they serve as a useful guide for companies considering SGIs.

- The individuals in the unit where the SGI will be installed should be interdependent.
- There is an objective, such as improved productivity/quality, better achieved by group than by individual effort.
- Clear criteria for achieving the objectives exist or can be developed with relative ease.
- The objective should be sufficiently important to the organization as a whole to muster support for the SGI.
- Any necessary, major changes in procedures, processes, technology or personnel should be made before the SGI is implemented. (If such changes occur after the plan has been installed, they could radically alter it.)
- The culture should be one of openness and trust between management and employees and among employees. The former is necessary for successful communication between management and employees and for employees to accept the incentive criteria as fair and workable. The latter is necessary for the members of the group to work together harmoniously and productively.
- The base compensation program should be soundly designed and not at odds with the team concept. For example, a merit pay system can exert a divisive effect at the same time the SGI is calling for a cohesive effort.

Exhibit 1, p. 12, gives a specific company's identification of the key issues to be considered in instituting a team approach, while Exhibit 2, p. 13 is one organization's conception of the type of culture conducive to team activities.

Exhibit 1

Readiness Assessment Issues

Paper Manufacturer

Few organizations embarking on an employee involvement effort are likely to exhibit all of the characteristics listed below. But during the assessment process an organization should examine these issues since each will have an impact on the long-term success of the effort.

Organizational Characteristics

- people can be rewarded and recognized for teamwork accomplishments.
- measurement data exist to describe important performance results.
- measurement data are shared with employees to let them know how they are doing.
- the labor-management climate is more cooperative than adversarial.
- communications methods exist which allow for a two-way flow of information between management and employees.
- departments cooperate to achieve common goals.

Employee Characteristics

- employees understand the need for productivity improvement.
- employees understand how their jobs contribute to team efforts and organizational success.
- people feel comfortable in sharing their ideas and concerns with their immediate supervisor.
- workers believe that management is concerned with their needs as well as the organization's needs.

Supervisor Characteristics

- supervisors perceive their role primarily as teachers, developers and coaches.
- they are not threatened by the knowledge, skills and contributions of their subordinates.
- they are experienced and skilled in leading meetings which encourage participation.
- supervisors believe that they will be rewarded for successfully adopting a participative management style.

Management Characteristics

- managers believe that employee participation can further the organization's goals as well as the individual employee's goals.
- management expresses respect for employees as valuable contributors to the organization.
- management expresses concern for employees' well-being and job satisfaction.
- managers frequently express appreciation for the contributions which employees make.
- management routinely shares business information with employees.
- managers explain organizational procedures and policies to employees.
- managers are receptive to employees' inputs to the decision-making process.

Labor-Management Characteristics

- management routinely shares business information with the union.
- management solicits union views and ideas regarding opportunities for improvement.
- management acknowledges union contributions to organizational accomplishments, when appropriate.
- union is interested in exploring different ways of carrying out the labor-management relationship.
- union is reasonably knowledgeable about productivity/QWL issues in operation.
- union is *not* very protective of its role in representing and communicating with members.
- union is dependable in implementing agreed upon actions.

Implementation

Once the organizational culture has been judged ready for SGIs, certain implementation decisions must be made.

On the basis of the objectives sought, should a particular group be for the life-of-project, permanent or renewable? The life-of-project group exists for a comparatively short time to perform a particular task. Once completed, it is disbanded. The permanent group, on the other hand, is often what Carla O'Dell calls a "natural work group."[5] This usually consists of employees in a common unit or function, who are refocused to act more systematically as a team. Another type of permanent group according to O'Dell is the "autonomous team."[6] Autonomous teams are created to change narrow, individualized tasks to more interdependent, flexible ones. The renewable SGIs are conceptually the same as the permanent ones, except they are reviewed periodically (usually once a year) to see if any changes should be made or if they are no longer viable and should be terminated.

What training is needed for the SGI to succeed? Often, the skills required to achieve the plan's objectives are the same skills required in the participants' existing jobs. However, autonomous teams may require cross-training and the acquisition of new skills to enhance flexibility.

What changes in the pay system are required? This must be handled carefully so different elements of the pay system do not conflict. Possible changes could include the combination of a team payment for joint effort with a merit increase for individual performance. For example, a bank has two pieces to the incentive payment—one for team performance and the other for individual contribution. In contrast, a manufacturing company with a gainsharing-type SGI makes the group incentive the sole "variable element" and gives across-the-board, general increases to reflect cost-of-living or job rate changes. The need for cross-training, mentioned above, might call for the introduction of a pay-for-knowledge system, which provides additional pay for each new skill mastered.

Do the criteria chosen directly or indirectly measure the achievement of the objectives? Are the targets of the plan under the control of the participants? Can they best be achieved by group effort? Also, the payment of the incentive must clearly and directly relate to the achievement of the goal.

Are there administrative systems in place that can monitor the group's progress toward the goal? Do these systems provide them with the information necessary to achieve the goal, and simultaneously give managers the information needed to evaluate the group's performance?

Initial Communication of the SGI

The success of SGIs and, in fact, any incentive system, depends in part on relatively open communications. Open communications foster mutual trust between management and employees. Management believes employees have the understanding and motivation required to grasp the nature of the goals and work for their achievement. Reciprocally, employees trust management to establish goals that are realistic and achievable and to provide fair, meaningful rewards for their attainment.

Exhibit 2

Statement of Organizational Culture

Paper Manufacturer

The commitment, ability and enthusiasm of *each employee* is central to achieving success in our division.

We will:

- provide an environment which enables and empowers employees;
- communicate openly and factually;
- treat each other with honesty, respect and dignity;
- foster teamwork and entrepreneurial spirit;
- develop mutually beneficial partnerships with customers; suppliers and communities;
- accept responsibility for quality and unsurpassed services for our customers; and
- strive for continuous improvement.

The initial communication of the program should embody such openness. The specific means, however, will vary with the individual organization. The emphasis is usually on relatively intimate meetings with the affected group and their managers. The degree of formality in these meetings is a matter of the particular style of the manager and the company's culture.

For instance, an electrical/electronics manufacturing company employs a somewhat formal style, where the initial communications involve a meeting between the manager and the SGI group. The manager uses a number of presentation aids, including overhead slides, a script, and handouts for each employee. A bank, by contrast, has the manager meet with the group but leaves the style and specific content up to the individual manager's judgment.

The initial communication is most important to the plan's success or failure. Whatever the particular methods used, there must be a clear statement of the plan's goals and the actions required by the group to reach the target and receive the incentive payment.

SGI Communication and Involvement

A successful small group incentive demands a cooperative effort by all the members of the group. To support such an effort, there must be a communication system that initially elucidates the actions and behaviors needed to achieve the goal, reinforces them during the group's progress towards that goal, continually reports on that progress, and disseminates any information the participants need to function effectively. The communication mechanism should also be a two-way channel, where employees not only receive information from management but also have a way to make suggestions and give management any other feedback that might prove useful. In addition to communication systems, several of the participating organizations reported various employee involvement programs that operate outside the SGIs but support and contribute to the achievement of the plans' goals.

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[5] Carla O'Dell, "Team Play," *Across the Board*, November 1989, p. 40.

[6] "Team Play," p. 40.

Communication

Twelve participants furnished details on the methods they use to review the progress of the plans and communicate the results. Most organizations (nine) communicate the plan's progress to participants monthly. Two communicate the review quarterly, and one has both monthly and quarterly communications.

Periodic meetings of the group with their manager are the most frequent way the progress of the plan is reviewed and communicated; these meetings simultaneously give the participants an opportunity to provide feedback and suggestions to their managers. Generally, these meetings are kept relatively informal, with considerable emphasis put on open exchange between the manager and the participants rather than more formal presentations by the manager to a relatively passive audience. Usually, written communiques, including memos, reports in employee newsletters and postings are also circulated. Sometimes charts or graphs detailing the plan's progress are created and posted. Some specific communications and review methods reported by the participants are described below.

An electrical/electronics manufacturing company, has a relatively detailed communications system, where managers use visual aids, a script and handouts to communicate the plan at the beginning of the incentive period. Subsequently, the manager gives detailed monthly results in meetings with the participants; these results are then posted throughout the facility. In addition, progress reports are included in the company newsletter. This particular company has a history of concern with and attention to employee communications and has developed a very comprehensive approach.

A support unit of a manufacturer holds monthly employee meetings during which the group's performance is reviewed against the measurements in detail. Unlike the first example, informality is emphasized, and employee participation is encouraged.

Exhibit 3

Employee Involvement Statement
Paper Manufacturer

All employees have a job to do, and, for the most part, it gets done. We are beginning to take the next step which involves:

- A recognition that the employee on the job is an expert on that job.
- A recognition that problems are solved best when they are solved closest to the source of the problem.
- A recognition that when the "Planners" plan and the "Doers" do the odds of success are diminished.

EMPLOYEE INVOLVEMENT is a *commitment* to *create* a *climate* where people have the *opportunity* to be involved in solving problems and the *desire* to take advantage of that opportunity.

The bank card collections unit of a commercial bank, which uses specific financial measures of unit profitability as the plan's criteria, tabulates the group's performance against these measures monthly. The results are initially communicated by the managers in memos and then discussed at meetings with the participants.

A unit of a manufacturing company, which offers automated business services, uses a wide variety of communication techniques, including presentations to the group by their manager, reports in the division's newsletter, and written monthly status reports. In addition, in a somewhat unusual process, the plan participants conduct a self-review of their contributions to the group objectives.

The HR/payroll processing unit of a manufacturing company departs from typical practice by having the progress of the plan reviewed and then communicated quarterly by an employee steering committee. This rotating group is responsible for the total plan, including development, administration and communication. The steering committee concept is most often found in productivity gainsharing systems.

A few organizations do not use oral communications. For example, a manufacturing company's protection services division posts monthly graphs and charts and distributes explanatory booklets. A bank posts the SGI results monthly but does not otherwise communicate them.

Involvement Programs

Some participants reported employee involvement programs, which supported the group incentive effort either directly or indirectly. The presence of these programs illustrates the kind of culture most conducive to group incentive effectiveness: one of participation, empowerment and interdependence. (For an example of one company's involvement statement, see Exhibit 3.) Involvement programs reported include the following examples.

- A manufacturing company expects employees to participate in continuous improvement groups that were formed to reduce defects and cycle time.
- A primary metals company has a system where the various SGIs are all part of a single program that also includes a formal labor-management participation feature.
- Two organizations have suggestion systems that provide channels for employees' suggestions and comments on the SGI.
- The automated business services unit mentioned above uses specific measures of revenue, costs and quality in its SGI. An employee involvement team, independent of the SGI, has been formed to enhance the achievement of these measures.

Plan Characteristics

Prevalence by Industry

In the 1990 Conference Board study, *Variable Pay: New Performance Rewards,* 54 (12 percent) of the 435 participants used SGIs. The distribution by industry group is shown in Table 2. In connection with the present study, 29 of these organizations provided details on their current SGI practices (see Method, p. 4). The distribution of the 29 by industry group is shown in Chart 1. For greater precision, the Financial Services category has been divided into Banking, Insurance and Miscellaneous Financial Services.

Number of Small Group Incentives Per Company

Thirteen organizations reported the number of SGIs. The median number of groups per company is seven. The middle 50 percent ranges from a low of four to a high of eight groups. Three organizations reported a single group; the greatest number is 50 groups, reported by a manufacturer.

Employee Levels Covered

The level of employees included in SGIs varies widely from organization to organization. Overall, the exempt salaried group most often participates. Some examples of specific practices with respect to the number of groups and the level of employees covered are as follows:

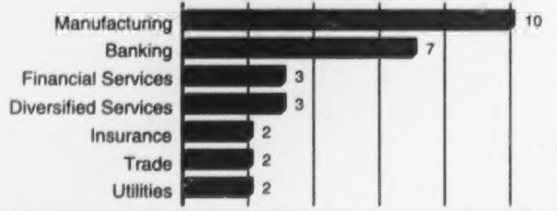
- A diversified services organization has four separate SGIs that draw from all employee groups except executives and sales personnel.
- A diversified financial services company has 20 separate SGIs some of which cover one level, while others cover more than one level. For example, one group includes only hourly employees and another includes just salaried and managerial employees.
- The manufacturing company with 50 separate SGIs includes only exempt salaried employees.

Table 2: Prevalence of Small Group Incentives (SGIs)*

Industry Group	*Total Number of Organizations*	*Number with SGIs*	*Percent with SGIs*
Trade	21	4	19%
Financial services	122	19	16
Manufacturing	185	24	13
Diversified services	35	3	9
Utilities	72	4	6
Totals	435	54	12%

*Charles Peck, *Variable Pay: New Performance Rewards,* The Conference Board, Research Bulletin No. 246, 1990.

Chart 1: Prevalence of Small Group Incentives



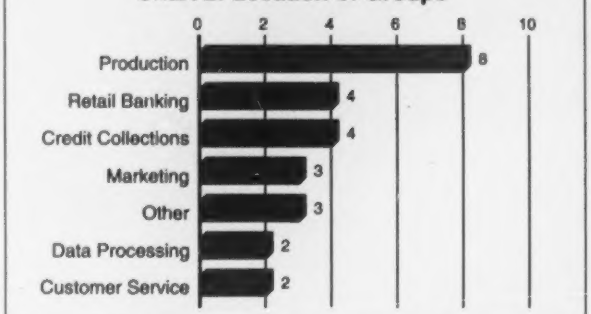
Size of Groups

The size of the median group, among the 24 organizations reporting this information, is 39 employees. The middle 50 percent range is from 30 to 50 employees. There is no apparent pattern in the size of the SGIs according to type of industry, but there may be some correlation with total employment. The smallest group reported consists of four employees in the consumer credit collections function of a bank with total employment of 1,581. The largest group reported is 1,900 field service employees in a diversified services organization. This organization has 60,000 employees, and what they identify as a "small" group is thus only 3 percent of the total. Perhaps this indicates that, like beauty, what is considered a "small" group lies in the eye of the beholder.

Location of Groups

The groups included in SGIs are located in various units within the participating organizations. Of the 26 locations reported, the greatest number are in production departments. Of seven banks, four SGIs are located in the consumer credit collections division. The prevalence by location is shown in Chart 2.

Chart 2: Location of Groups



Criteria Used to Determine Awards

As shown in Table 3, the criteria used to determine incentive awards are most often based on financial performance and production objectives. Customer satisfaction and quality are employed less frequently, and measures of hours and safety were least often used.

There is some patterning of the criteria by industry. As might be expected, in the manufacturing sector the majority (70 percent) of the SGIs use production criteria, while all the reporting banks use criteria relating to financial performance.

The level of employees covered also appears to have an influence on the type of criteria used. Those plans which cover exempt employees tend to use financial performance standards, while those covering nonexempts are more inclined to use production standards.

Examples of the criteria used in the participating organizations are shown in Table 4.

Life of Plans

Of the 14 organizations that reported the duration of their current SGIs, 7 are permanent, and the other 7 are renewable from year to year. No current "project duration" SGIs were reported. There is no apparent variation according to industry or performance criteria.

Incentive Payment

Annual Payment and Relationship to Base Pay

There are two different approaches to the relationship of base wages and salaries to incentive compensation. In the first, base wages and salaries are set at the level desired by the organization in relation to the compensation paid by other organizations, and in consideration of business and internal conditions. In these cases, the SGI payment is strictly additional compensation on top of competitive base pay. In the second approach, base pay is deliberately set below the organization's desired competitive position, with the SGI providing the opportunity to make up or exceed the difference between actual and competitive pay. Thus, two opposed pay philosophies are used; on the one hand, the SGI is viewed as extra compensation on top of fixed wage or salary and, on the other, the SGI is considered "pay at risk." It fluctuates according to the performance of the group.

Table 3: Small Group Incentive Criteria

Criteria	Number of Times Mentioned	Percent of Organizations Mentioning
Financial performance	26	93%
Production objectives	14	50
Customer satisfaction	7	25
Quality	7	25
Measures of hours	3	11
Safety	2	7

Note: Respondents could report multiple criteria.
N=28

The majority of the participating organizations, 16 of the 23 answering this question, set base wages and salaries at competitive levels, with the SGI payment representing additional compensation. Among these, the median SGI annual payment is 4 percent of base compensation. The middle 50 percent range is from 3.5 to 5 percent. Among the seven companies that set base at less-than-competitive rates, the median annual payment is 7.9 percent of base pay. The middle 50 percent ranges from 3.6 percent to 10 percent. Thus, in the "pay at risk" approach, there appears to be more incentive opportunity as indicated by the higher median and 75th percentile.

An example of an organization that offsets base pay is a bank, that sets salaries in its consumer credit collections division at 75 percent of the market rate for comparable jobs. The combination of salary and the incentive payment from the SGI can exceed "market" if the performance goals are met. Another example is a manufacturing company, which sets wages and salaries at less-than-competitive rates to place a portion of total compensation at risk and reduce the size of base pay increases.

The median annual payment among 29 SGIs is 4 percent of base wages or salaries. The middle 50 percent range is from 3.6 to 5 percent; the lowest payment is 0.4 percent reported by a manufacturer for an SGI consisting of 36 production employees. The highest

Table 4: Type of Measurement

Type of Criterion Used	*Specific Measurement*	*Industry Group*
Financial performance	Net operating profit after taxes	Manufacturing
Financial performance	Consumer collections division measures reduction in dollars bank charges-off	Financial services
Financial performance	Money recovered in excess of department target	Financial services
Production	Measure inches of silicon wafers processed per hour	Manufacturing
Production	Accomplishment of specific project tasks	Diversified services
Production	Increase in numbers of payment promises kept	Financial services
Customer service	Measure 6 defect and 4 cycle time reduction measurements that affect the customer	Manufacturing
Customer satisfaction	Customer opinion surveys	Utility
Improved quality and customer satisfaction	Retention of customer accounts	Diversified services
Improved quality	Customer feedback	Utility

reported is 25 percent; paid by a retailer to a group of 100 administrative employees. The median annual payment among 13 manufacturing organizations is 3 percent, while it was 10 percent for five banks. There was insufficient response from the other industries for analysis of their payment patterns.

Relationship to Other Compensation Plans

Eight of the 13 organizations answering this question have more than one compensation plan (excluding base pay programs) for the SGI participants. The remaining five only have the SGI plan plus base wages or salaries. Some examples of the former include profit sharing, an incentive plan based on the achievement of company-wide goals, payments for sales referrals, and individual incentive plans.

Form and Frequency of Small Group Incentive Payments

The SGI incentive is most often paid by a check separate from the regular pay check. This highlights the incentive and prevents it from being considered simply a part of base pay. Of the 13 responses to this question, 11 pay by a separate check. These checks are distributed to employees annually in six cases, and quarterly in five.

The two organizations (both banks) that include the incentive in the regular pay check, pay it on a monthly basis.

For examples of the mechanics of recommending and paying incentive awards see Exhibits 4 and 5, pp. 19 and 20.

Exhibit 4

Guidelines for Awards

Primary Metal Manufacturer

Guidelines

- All employees who were assigned to nonrepresented salaried exempt and nonexempt positions during the payment year in units covered by the plan are eligible to participate.
- Two groups of the Plan participants are designated:
  - *Group A Participants*—incumbents of key positions for whom Annual Results Agreements were established.
  - *Group B Participants*—incumbents of nonrepresented salaried positions for whom the Annual Results Agreement of their supervisors apply.
- In order to receive an Annual Results Award, a participant must be covered by an Annual Results Agreement which:
  - has been approved by higher level supervision, and
  - has an Individual Results Score of greater than 0.00.
- If a manager wishes to recognize each of his/her team member's individual contribution to team results, each team member's Annual Results Award can be adjusted by an Individual Results Rating factor ranging from a minimum of .50 to a maximum of 1.50. However, the average of the Individual Results Ratings for all team members must equal 1.00.
- An employee may be excluded from an Annual Results Award because of unsatisfactory performance.

Annual Results Award Payments

- Annual Results Award payments will be made in cash by separate check on the payday closest to March 31 of the succeeding year.
- These payments will be treated as supplemental wage payments. Federal Income Tax will be withheld at a flat 20 percent rate and State Income Tax in accordance with the applicable state law for supplemental wage payments.
- Annual Results Awards are one-time special payments which are not added to Base Salary or considered for benefit determinations.
- Participants should be informed on a one-on-one basis of their Target Position Award, Total Results Score and Annual Results Award amount prior to actual payment.
- A participant who resigned during the payment year or who resigns prior to actual payment of the Annual Results Awards will *not* be eligible to receive one.

Exhibit 5

Incentive Awards

Primary Metal Manufacturer

XYZ CORPORATION Interoffice Correspondence

Ref:

To:

From:

Subject: *1991 Annual Results Award Payments*
ABC Department

Attached are lists which indicate the Annual Results Awards earned by active (List A) and inactive (List B) nonrepresented salaried employees in the ABC Department.

A summary of these award payments follows:

Employee Status	*Employees*	*Total Award Payments*	*Average Award Payment*
Active			
Inactive			
Total			

For active employees, please make these award payments by separate check on the payday closest to March 31, 1992.

For inactive employees, please make these award payments by separate checks mailed to their homes.

* Note: an inactive employee is a person who terminated during the payment year because of retirement, approved leave of absence, temporary or permanent layoff, or death.

(Department Head Signature)

cc:

Case Studies: Small Group Incentives in Different Industries

Some examples of actual SGIs in different industry sectors are described in this section. To give an idea of the diversity of practices encountered, cases have been selected from the two major users of SGIs—manufacturing and banking—as well as from diversified services and utilities.

Manufacturing

Rubber Manufacturer

This organization has 20 small group incentive plans and furnished a description of a typical one. The particular group consists of 161 production nonexempt and exempt salaried employees, who are not included in any other incentive compensation plans. They receive, on average, 7.5 percent of pay annually. The payment is in addition to competitive base salaries and is paid in a separate check. The primary objective for using SGIs is to increase productivity; the second objective, to improve motivation. The third stated objective is to decrease turnover. The organization was very successful with the achievement of all three objectives. Quarterly departmental meetings are used to communicate and facilitate the SGI process.

The award criterion is improved production practices. This is a permanent plan, which has been in place for three years. The plan has worked so well that the typical payment has increased from 5 to 7.5 percent.

Chemical Manufacturer

This organization has two small group incentive plans, and reported in detail on one. This plan covers 36 employees who are hourly and nonexempt salaried production employees not included in any other incentive compensation plans. They receive an average of 4 percent of base pay, which is paid out quarterly. The payment is in addition to competitive base salaries and is paid in a separate check. The primary SGI objective is productivity improvement; the second objective is to promote safety. The third major objective is to increase quality. The organization reported partial success with the first objective, and full success with the second and third. Monthly safety meetings are used to communicate and facilitate the SGI process.

The award criteria are production objectives, specifically inches of silicon wafers processed per hour. This is a renewable plan and is reviewed each year. An unforeseen problem arose in connection with the criteria during a period of change when new equipment and new personnel were introduced. The SGI became a disincentive during the period of adjustment, because it paid out so infrequently. However, once the group became familiar with the equipment and each other, the plan once again succeeded.

Banking

Bankcard Recoveries

This bank has one small group incentive plan consisting of 42 exempt employees, who can receive up to 10 percent of pay monthly. Salaries are set *at less than* competitive rates; specifically, at 75 percent of market. Employees also receive an individual commission for each successful collection effort. If the performance goals are met, total cash compensation can exceed competitive rates. The incentive is included in the employees' regular pay check. The primary objective for using SGIs is to build a team spirit; the second objective is to encourage higher productivity and cooperation. The third objective is to reduce the amount paid in individual commissions. The organization is very successful with the first two objectives and reports success with the third objective. To communicate and facilitate the SGI process, the organization holds monthly meetings and posts plan results on a bulletin board.

The award criterion is financial performance, measured by the dollar amount recovered in excess of the department target. This is a permanent plan, which has been in place for three years. The plan has worked so well that the typical payout has increased from 6.9 percent to 10 percent, and the group has expanded from 30 employees in 1989 to 42 employees in 1992.

Diversified Services

Payroll/HRIS Processor

This organization has over 15 small group incentive plans. The size of the particular group reported on is 55 employees. This group includes hourly, nonexempt salaried, exempt salaried, and managers. Employees receive on average 2 percent of base pay, which is paid out quarterly; this payment, in addition to competitive base wages and salaries, is in a separate check. The primary objective for adopting SGIs is to increase employee empowerment/involvement; the second objective is to improve productivity and quality. The third major objective is to improve teamwork and employee morale. The organization reported success with all three objectives. To communicate and facilitate the SGI process, the employee steering committee that develops, administers and communicates the plan holds, at a minimum, quarterly meetings with the participants. Supporting programs include a suggestion system and quality action teams.

The award is based on customer satisfaction, as measured by opinion surveys, retention of accounts, decreased errors and gross profit. Employees in this SGI are also included in a competitive excellence bonus program, where they can earn 2 percent of pay based on annual profits.

Technology Development

This organization has one small group incentive plan, including nonexempt and exempt salaried employees. These employees receive an average of 8 percent of base pay monthly. The payment is in addition to competitive wages and salaries and is paid in a separate check. The primary SGI objective is increased productivity. The second objective is improved quality, and the third objective is employee retention. The organization said they have been very successful with all three objectives. Monthly meetings are used to communicate and facilitate the SGI process.

The award criteria are financial performance and production goals, including the accomplishment of specific project tasks. This is a permanent plan, which has been in place for over five years. The plan has worked so well that the typical payout has risen from 6 to 8 percent. The plan was originally implemented in 1987 to slow the growth of base salaries; the incentive was intended to counteract the negative effect of slower salary progression.

Public Utilities

Customer Service

This organization has 10 small group incentive plans. Ninety-seven nonexempt and exempt salaried employees are in the group reported on in detail. They typically receive 2.5 percent of pay quarterly (in a separate check); the payment is in addition to competitive base wages and salaries. The primary objective for adopting SGIs is to focus the group on the goals (particularly financial performance and quality) that management sees as important; the second objective is to foster teamwork. The organization was very successful with the first objective and successful with the second. It communicates and facilitates the SGI process in quarterly departmental meetings.

The award criteria are measurements of financial performance and customer service surveys as the measurement of quality improvement. The plan can be renewed annually. At this point customer satisfaction has improved *above* what was thought possible. Employees in this SGI are also included in a corporate incentive plan where they can receive a maximum of 2 percent of base pay.

Effectiveness of Small Group Incentives

Twenty-two of the 29 survey participants ranked the importance of their major objectives in adopting small group incentives (see Table 5). Their most important (number-one ranked) objectives can be distributed among the following five categories.

Financial objectives: The achievement of financial goals is measured by a standard of financial performance applicable to the participating group. For example, the retail banking section of a commercial bank measures SGI performance in its branches by increases in sales. Such financial objectives were most often found among banks.

Task-specific objectives: These objectives usually relate to a specific situation unique to the particular organization. For example, a manufacturing company formed SGIs in order to dissipate a conflict about eligibility for overtime among production personnel.

Productivity/Quality objectives: These usually consist of measures of productivity, often a formula measuring output (production) minus input (costs). Quality is an adjunct to productivity insofar as errors or defects reduce usable output and increase costs. These objectives were found exclusively among manufacturers and public utilities (although there is no reason why they could not be used in other types of organizations).

Cultural objectives: These objectives more often describe a desired condition rather than actions to reach a goal. For example, a frequently stated objective of this type is the encouragement of a culture promoting teamwork and employee interdependence. Such an objective is not concretely measurable, and, as such, is a by-product rather than a measurable end-product of the SGI process. These objectives were found among all the industry groups.

Compensation objectives: In these cases, the major objective relates specifically to the compensation part of the incentive. In every instance, the objective was to link pay to measured performance through the SGI.

The distribution of the most important objectives of the 22 SGIs among the five categories and the industry sectors is shown in Table 5.

Degrees of Success

The 22 organizations also rated the degree of success they experienced in achieving their most important objectives. The degrees of success were: very successful, successful, partially successful, and not successful. The basis for the rating, of course, could range from very objective in the case of quantifiable objectives, to subjective in the case of cultural ones. It must be kept in mind that the latter are always prey to a "rose colored glasses" evaluation, since managers with a vested interest in the success of the plan are subjectively assessing the results.

Table 5: Most Important SGI Objectives

		Industry Sector				
Objective	*Total*	*Manufacturing*	*Banking*	*Utility*	*Trade*	*Diversified Services*
Financial	6	–	4	–	2	–
Task-Specific	5	2	1	–	–	2
Productivity/Quality	4	3	–	1	–	–
Cultural	4	1	1	1	–	1
Compensation	3	2	1	–	–	–
Totals	22	8	7	2	2	3

Nine plans were rated "very successful" in achieving the most important objective. Nine were "successful," and four, "partially successful." There were no reported failures. The distribution of the 22 plans according to the degree of success attained and industry sector is shown in Tables 6, 7 and 8.

When the very successful and successful plans are compared, there is little difference in the types of objectives reported. The very successful plans often have financial goals, but most very successful plans are found among banks, which tend to use financial targets. This makes it impossible to determine which has more weight—the type of industry or the type of objective. Among the successful plans, the highest proportion report compensation goals. Overall, however, no clear distinction emerges between the objectives of very successful and successful plans.

When the partially successful plans are examined, the objectives are all measurable by concrete criteria and fall into either the productivity/quality or financial categories. In these cases, there is little ambiguity about the degree of success because of the specificity of the measures. The manufacturer reporting partial success has a gainsharing-type SGI with a mathematical formula for measuring the productivity of the group. The utility has measurable criteria for determining quality improvement. Elucidating the reasons for partial success, the manufacturer said that after a period of im-

Table 6: Very Successful SGIs

		Industry Sector			
Objective	*Total*	*Manufacturing*	*Banking*	*Utility*	*Diversified Services*
Financial	3	–	3	–	–
Cultural	3	–	1	1	1
Task-Specific	2	1	1	–	–
Productivity/Quality	1	1	–	–	–
Totals	9	2	5	1	1

Table 7: Successful SGIs

		Industry Sector			
Objective	*Total*	*Manufacturing*	*Banking*	*Trade*	*Diversified Services*
Compensation	3	2	1	–	–
Productivity/Quality	2	1	–	–	1
Cultural	2	1	–	–	1
Financial	1	–	–	1	–
Task-Specific	1	1	–	–	–
Totals	9	5	1	1	2

Table 8: Partially Successful SGIs

		Industry Sector			
Objective	*Total*	*Manufacturing*	*Banking*	*Utility*	*Trade*
Productivity/Quality	2	1	–	1	–
Financial	2	–	1	–	1
Totals	4	1	1	1	1

provement, productivity leveled off. This leveling off haunts permanent incentive plans based on continuous improvement formulas. The recommended solution is the "renewable" approach where the plan is periodically reviewed; otherwise, the plan is always in danger of becoming a disincentive by failing to pay out.

When financial measurements are used, it is relatively easy to determine the degree of success achieved. The one bank reporting partial success had a goal of increasing branch sales in its retail division; the trade company had an earnings per share goal.

Not quantifiable, but probably important to plan success are intangibles in the individual company's culture, conditions within the industry, and the company's position with respect to markets, materials and competition.

Unforeseen Results

In addition to formally rating their success in achieving the stated objectives, participants were asked to describe any unforeseen outcomes, either negative or positive, resulting from the operation of the plan. Eight organizations reported such results, as summarized below.

- A manufacturing company, which rated its SGI partially successful, found that the incentive was earned less frequently than anticipated. This was attributed to changes resulting from the installation of new equipment and turnover in personnel. This illustrates the importance of one of the caveats given in the section on implementation—an SGI should not be installed in advance of major changes in personnel or technology.
- A primary metals company discovered that it had to be vigilant against participants "gaming the system"; that is, cutting corners in order to meet time standards thus forcing an incentive-payment to the detriment of equally important quality considerations. This company also found that some of the goals for the plan set by management were unrealistic.
- Two service organizations had the pleasant surprise of finding that employee interest and involvement remained high even in the face of adverse circumstances. In one case, the plan did not pay out, and in the other case, there was a period of downsizing with the accompanying angst and disproportionate workload for the remaining employees.
- An automated business services organization experienced the fortuitous result of employees proving unusually creative at cost control. On the negative side, it found some unreasonable goal expectations were created as a result of the over-enthusiasm with which the plan was originally communicated.
- A manufacturing company saw the objectives of teamwork, interfunctional cooperation, and continual process improvement surpass expectations, as did a utility with respect to its customer satisfaction goals.
- An unforeseen drawback in a bank's otherwise successful plan occurred in the third year when incentive payments diminished and dissatisfaction arose, apparently from participants viewing the incentive as an entitlement rather than compensation at risk.

Small Group Incentive Cancellations

Ten companies, with what they thought were permanent or renewable SGIs, reported discontinuing them. Three provided details, which are summarized below.

- A utility had SGIs covering the five senior employees at electric power plants. The plan objectives were productivity (improving plant availability), meeting the operations and maintenance budgets, and reducing costs by improving the "heat rate." Specific measures were used to evaluate the achievement of each objective. The incentive paid, on the average, 8 percent of the members' base compensation. However, it appeared that individual contributions were being lost in the group process to the detriment of personal motivation and initiative. As a result, although the group structure was retained, the incentive was based on individual performance rather than the total performance of the group.
- A primary metals company had small group incentives for supervisory personnel in steel processing facilities. Typically, there were 10 employees in each group. The objectives that were measured related to efficiency of operations, volume of production, and cost effectiveness. From time to time there were also major projects that were put under the incentive system and evaluated as to timely completion within cost limits. The plan did not meet the efficiency goals sought and only partially met the other goals. Management concluded that a plan based on individual contribution might yield better results, so it instituted a system of individual incentive awards.
- A small group incentive was installed in a company manufacturing peripheral computer equipment that had been acquired by another manufacturing company. The SGI covered per-

sonnel, whose group performance was evaluated according to their achieving or beating project milestones. A subordinate objective was retention of the key employee group in the acquired company. However, the milestones were often not fully met, and the plan did not have the hoped-for motivating effect. The failure of the plan was attributed to inadequate initial communication, and management canceled the plan rather than trying to salvage it.

The object lesson that emerges from the last case is the importance of effective communications. In the sad sagas of the other two, the uneasy relationship between group and individual incentives is highlighted. There is an inherent tension between the two concepts, which often causes organizations to fluctuate back and forth between the two forms of incentives. This reflects ongoing uncertainty about the proper melding of team play and individual performance, an issue more basic than mere compensation considerations.

Conclusion

Interest in variable pay plans generally, together with companies' ongoing effort to promote teamwork, has sparked interest in SGIs.

Predictions are that this interest will cause a proliferation of SGIs. For instance, in its 1987 study, The American Productivity and Quality Center predicted that the number of SGIs would almost double.[7] If, and when, this occurs, the growth in new plans will doubtlessly level off. Good and bad experiences with SGIs will ensure a certain level of ongoing activity as defective or outmoded plans are canceled and new or revised ones are adopted.

Present indications are that SGIs are most widely used in manufacturing and commercial banking. The nature of the tasks in these organizations lend themselves to the formation of groups. For instance, the interrelated plant production processes in manufacturing provide fertile ground for SGIs. In fact, SGIs have proved a good answer to the disadvantages of the individual piecework plans often found in manufacturing companies. SGIs are easier to administer than a multitude of individual incentive arrangements. Also, technology has deemphasized the role of the individual producer at the plant level, and the present emphasis on cooperative work groups is consistent with SGIs. The processing functions found in commercial banks are equivalent to plant production. The overlapping involvement of employees in these functions provides a natural segue into the formation of SGIs.

Some excellent examples of SGIs are found in public utilities. Utilities occupy a mid-ground between manufacturing and services, often combining in their SGIs the "hard" measures of production with an attention to quality and customer satisfaction. Deregulation in the utilities industry will further the opportunity for incentive arrangements, including SGIs. While the labor-intensive nature of nonfinancial services suggests a good fit with SGIs, it appears to be difficult to establish concrete measurements. However, as the service industry gains more experience with incentives, the measurements will improve.

On a final note, SGIs, like other group incentives, are often more an expression of an organization's culture than simply a compensation technique. To succeed, there must be a positive synergy between the culture and the SGI process.

Related Conference Board Publications

Recognizing Quality Achievement: Noncash Award Programs, **Report No. 1008, 1992**

Restricted Stock for Employee Motivation, Reward and Retention, **Report No. 997, 1992**

Top Executive Compensation: 1991 Edition, **Report No. 983, 1991**

Gainsharing for Productivity, **Report No. 967, 1991**

Variable Pay: New Performance Rewards, **Research Bulletin No. 246, 1990**

New Strategies and Innovations in Compensation, **Report No. 931, 1989**

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[7] "Team Play," p. 40.

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Report Number 1008

Recognizing Quality Achievement: Noncash Award Programs

According to survey results, firms with a total quality process are:

- *developing multiple award programs*
- *stressing ceremony and symbol*
- *spreading the base of recognition-givers*
- *expanding the list of award-eligible activities*
- *melding noncash awards with other quality incentives*
- *using the award process for quality self-assessment*

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Recognizing Quality Achievement: Noncash Award Programs

by Kathryn L. Troy

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Prior to joining the Board, Ms. Troy was employed for 13 years in the corporate sector as a business planner and reasearch manager at major divisions of Time Inc. and CBS Inc.

From the President

A prerequisite for a successful total quality management effort is a work force that is willing to change: to think and to work in new ways. Employee recognition is a powerful tool for reinforcing such change. Through a number of programs, including noncash incentives, companies are celebrating employee contributions and achievements.

This report profiles steps companies take to design, implement and monitor a noncash recognition program. It also examines how such a program can serve as a building block toward a system of total quality incentives. This study is part of the Board's continuing research in the quality and productivity area; a related report on small group incentives is also available from The Conference Board.

We are grateful to the executives who participated in this study for sharing their experiences and insights on these recognition programs.

PRESTON TOWNLEY
President and CEO

Executive Summary

Recognition, ceremony and symbol are important underpinnings to the successful functioning of a total quality management (TQM) process. An expression of appreciation for a job well done, recognition can be as informal as a written or verbal "thank you" or as formal as the plaques and certificates presented at a CEO-hosted quality award banquet. This process both affirms employees' value to the organization and reinforces the cultural and behavioral change TQM requires.

In addition to its role in reinforcing quality-related behavior and achievement, recognition is used as a self-assessment tool by half of the respondents to this survey. Self-assessment involves company divisions, teams or other groups in the process of measuring their achievements against a set of pre-established criteria for quality excellence. Some firms use the criteria developed by the United States government for the Malcolm Baldrige National Quality Award, while other companies develop their own criteria. Recently, several states, professional associations, and government agencies have established quality awards. And organizations outside the United States have developed award programs as well. A sample cross section of these programs is summarized in the Appendix, pages 34-53.

A key objective for many firms with a TQM process is to develop and coordinate a portfolio of incentives tied to quality achievement, ranging from compensation, promotion and formal awards to informal reinforcement of everyday behavior. This study focuses on practices companies use to design, initiate and monitor a formal program of noncash recognition. Prior Conference Board research has shown that noncash awards are an important initial step in building recognition for quality achievement. In designing a formal program, respondents report that they rely heavily on their own past experience as well as that of other companies. Attendance at seminars or workshops, or participation in employee surveys, are among the other sources used. Surveys may be conducted during the design phase or after a program is in place for a year or two.

Often a major goal of a recognition process is to expand the base of those who are acknowledged both formally and informally. Respondents typically had more than one award program and the number of programs is likely to increase over time. Usually, all managers and nonmanagers are eligible, and 10 percent of managers and 17 percent of nonmanagers are recognized through formal programs. But, as more programs are added, the percentage of those recognized grows.

The list of recognition-givers and roster of award-eligible activities also expands as the program ages. In new programs, recognition-givers are frequently peers, immediate supervisors and top management. As the program evolves, other executives join the list, as do customers and subordinates. Early on, employees are applauded for outstanding achievement, completion of such quality-related activities as training or teamwork, suggestions, innovation or system and process improvements. Problem-solving, leadership and goal-related performance are added to the list as managers and workers grow in TQM sophistication.

Ceremonies and celebrations appear to be key to a successful recognition process, and may be the only aspect that potentially carries a significant price tag. Other activities that top the list are personal letters of commendation, the awarding of plaques or certificates, and spotlighting employees on company bulletin boards or in employee publications. All of these are basically low-cost items. All told, the typical respondent spent around $50,000 on a noncash award program. However, companies with the largest employee base spent over $600,000, and those with the smallest, about $30,000.

Based on their own experience, participants report that the effectiveness of incentives in reinforcing commitment to quality varies. Ceremonial occasions remain very important to nonmanagers and middle managers throughout the life cycle of a TQM process, and they tend to grow in importance among senior managers after the process has become established. Whatever the age of the TQM process, respondents believe that compensation tied to quality performance remains the most powerful incentive to commitment among top managers. After TQM has been in place a few years, this incentive becomes effective among middle managers and, over the long term, with nonmanagers.

Symbols and other noncash recognition are more effective with middle managers and nonmanagers than with senior management. Such incentives are one of the tools top management uses to telegraph its resolve to "walk the talk" of quality to subordinates. Whether cash awards are also a critical element to an evolving recognition program is a point on which respondents disagree. But a majority of firms do have at least one cash awards program.

Respondents report that they gather feedback and adjust their goals as their recognition program matures. Only 9 percent of firms with new programs had evaluated results; in companies with programs two-to-three years old, this number had risen to half. In companies with programs in place for five years or more, 80 percent have made an assessment. The vast majority of firms—two-thirds—say the recognition program has been positively received by employees. Early on, communicating the recognition program and promoting understanding of its philosophy and mechanics are priorities. After about two years, program expansion and consolidation top the list. Respondents also stress the need to make recognition a part of the culture, a tool for all managers, not just those at the top. Subsequently, as companies add award programs and expand the base for eligibility, they focus on deepening managerial and employee understanding of recognition and the range of award options. Many companies with the oldest programs concentrate on melding the components of company recognition into one system. Ultimately, their goal is to integrate recognition into the quality process and to link it more securely to business results.

Method

This report is the third study prepared by The Conference Board's Quality and Productivity Research program that focuses on the human resource aspects of implementing a total quality management (TQM) process. Prior research has investigated how companies mount quality training efforts and what they do to spark employee buy-in to total quality.

Questionnaires for this study were mailed in late 1991 and early 1992 to the corporate office of the 800 largest U.S. firms, based on financial size. Company names were drawn from the 1991 Fortune 500 manufacturers and Fortune 500 service firms. A few smaller companies known to have a noncash recognition program were also included. Companies which administered recognition on a decentralized basis were encouraged to send the questionnaire to one or more of their operating units for response.

Responses were received from 140 companies; 115 had a total quality management (TQM) process and 96 had a noncash recognition program linked to quality achievement. These 96 responses (based on 93 corporations) form the basis for the data reported in this study. About 40 percent of responses came from company units, and the remaining 60 percent from the corporate office. In the universe of 1,000 large companies, there is no firm figure on the number of corporations with a TQM process. However, based on prior survey work and the Board's ongoing interaction with quality executives, it is probable that the corporations responding account for roughly a quarter of the total universe of large companies with a TQM process.

The survey tables utilize percentages of respondents in order to facilitate a discussion of patterns and broad trends. However, either the table base or the actual numbers of responses to an item is also included to indicate the sample size. Given the evolving nature of the total quality process, and of recognition programs as part of that process, these findings are not definitive, but do provide a useful snapshot of current central tendencies in policy and practice among large firms with a TQM process.

The tables on page 9 profile key characteristics of the 96 survey participants. Most of the respondents had a title related to total quality (76 percent) or human resources (14 percent), with the remainder distributed among such functions as consumer affairs, sales and operations. Manufacturers outnumbered service firms by two to one and tended to have a larger number of employees. On average, respondents instituted a TQM process in 1988 and have had a noncash recognition program for about four years. In some cases, the recognition program predated the introduction of TQM and was expanded to include employees quality achievement activities.

Method Table 1: Size of U.S. Employee Population in Participating Companies

Grouped by Industry

	Number	Percent	*Employee Size (N = 87)* Under 4,000	4,000-10,000	10,000-30,000	30,000 or more
Manufacturing:						
Durable Goods	37	60%	22%	16%	22%	41%
Nondurable Goods	25	40	32	18	36	14
Total Manufacturing	62	65	26	17	28	30
Service:						
Financial Services	19	56	32	32	10	26
Other Services	15	44	14	36	36	14
Total Services	34	35	24	33	21	21
Total (All Companies)	96	100	25	23	25	26

Method Table 2: Financial Size of Participating Companies *

Grouped by Size of Employee Population (Financial Size in Billions – 1990)

	Operating Revenue		*Assets*		*Sales*			
	Under $2	*$2 or more*	*Under $15*	*$15 or more*	*Under $1*	*$1-$4*	*$4-$10*	*$10 or more*
Number of Employees								
Under 4,000	1	–	4	2	10	1	–	–
4,000 to 10,000	3	1	4	–	2	7	–	1
10,000 to 30,000	2	3	1	1	1	7	6	–
30,000 or more	–	2	–	4	–	1	6	9
Total	6	6	9	7	13	16	12	10

* Financial service firms reported assets; transportation service and utilities firms operating revenues; all others reported sales.

Method Table 3: Age of Total Quality Management and Noncash Recognition Process

Grouped by Major Industry Sector

***A. Age of TQM Process** (N = 95)*

	0 to 2 Years	*3 to 4 Years*	*5 to 7 Years*	*8 Years or More*
Manufacturing	20%	33%	33%	15%
Service	29	41	12	18
Total	23	36	25	16

***B. Age of Noncash Recognition Process** (N = 89)*

	One Year or Less	*2 to 3 Years*	*4 to 5 Years*	*6 to 7 Years*	*8 Years or More*
Manufacturing	12%	29%	23%	14%	21%
Service	18	27	18	21	15
Total	15	28	21	17	20

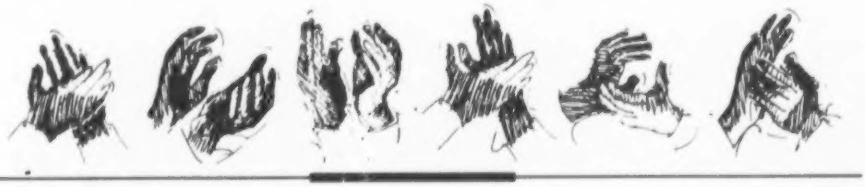
The Importance of Employee Recognition

Applause: "Great effort; Let's celebrate!" This is the language of a Broadway opening, a Marathon or a Pennant race, not the workplace. But companies with a total quality management (TQM) process are changing that attitude. Applause, recognition, and celebration are crucial quality tools—a confirmation that the company encourages its people to "walk the talk" of quality.

Making Recognition Part of the Atmosphere

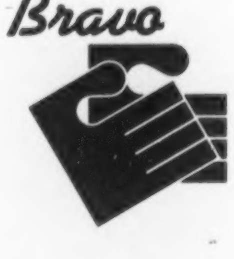
A fair salary and benefit plan remain high on the priority list for today's workers and managers. But once employees determine that their compensation meets the market test, other factors become more crucial to job satisfaction. One of these is "appreciation for a job well done." And that'is what recognition is all about. Recognition may be a pat on the back, a verbal or written thank you, a photo or write-up for the employee periodical or bulletin board, or the opportunity to be acknowledged at a major company event. Symbols play an important role in recognition. For example, Dun & Bradstreet Software uses clapping hands as a program logo, and Alliant Techsystems uses them as an award (see Exhibit 1). Other awards, such as a plaque, certificate, article of clothing or jewelry, a dinner voucher, theater tickets, or cash serve as tangible reminders of the company's appreciation of employees' achievements.

Exhibit 1: Applause is Symbolic



LOGO FOR RECOGNITION PROGRAM, DUN & BRADSTREET SOFTWARE

LEADERSHIP THROUGH EXCELLENCE



ALLIANT TECHSYSTEMS: BRAVO AWARD

Purpose
To provide an informal way for peers to give each other a "hand" for individual or team efforts. The award can be used to recognize multilevel, cross-functional or intradepartmental efforts.

Description
Individual clear acrylic hands (wood hands for ESD sensitive areas) that can be combined by the recipient to create a unique sculpture.

Eligibility
Any employee or team.

Criteria
Performance exemplifying one or more of the identified keys to success.

Process
1. Obtain the Bravo form and hand(s) from your department administrator.
2. Complete the form.
3. Give the original form and the hand(s) to the recipient(s).
4. Give a copy of the form to the location coordinator.

An effective employee recognition program is usually considered key to the human resource practices which accompany the introduction of a TQM process. TQM often requires a significant change in the management environment and basic culture of a company. Managers and workers are encouraged to:

- focus on the needs of internal and external customers;
- strive for excellence in executing each task, product or service, or process; and
- commit to continuous improvement of all company activities.

As the structure of the organization becomes flatter and less hierarchical, managers are transformed into leaders and coaches. Individually or in teams, employees are encouraged to make suggestions about ways to improve their work. Some teams become self-managing, and members are empowered to make decisions about day-to-day work processes. To succeed, such change requires considerable support from the top. Management must make employees aware of executive expectations and help them understand TQM theory and practice. In addition, managers must recognize and reward employees when they exhibit the attitudes and behavior that will make the TQM process a success.

Unlike some traditional management systems, TQM is not preoccupied with identifying and correcting those employees who are doing things *wrong*. Rather, managers are asked to applaud, recognize and reward the employees who are doing things *right*. The objective is to permeate the organization with an appreciation of the power of recognition. Says the quality executive in a transportation services firm:

> "Our leadership process is defined as a systematic, data-oriented approach to managing people through the use of positive reinforcement. Recognition for accomplishments is the basis."

Considering the Alternatives

In practice, quality recognition falls into three categories: day-to-day reinforcement such as a personal note commending a job well done; informal acknowledgments such as spot cash awards or photos on company bulletin boards featuring employees who have achieved a quality goal; and formal programs. Formal programs are publicly announced by the management of the company, have a defined set of guidelines, an application and review procedure and a prescribed outcome, such as an award ceremony or receipt of a certificate.

Some firms encourage recognition, but have no formal program, leaving implementation to individual managers and units. Other firms set goals or monitor progress. For example, management might suggest that each work unit recognize at least five people per quarter. Or, a company may track the number and types of awards offered. In many companies, informal practices coexist with a formal program. One purpose of the formal program is to encourage broader formal and informal recognition companywide. "We encourage all employees, not just managers, to recognize one another," says a respondent from a pharmaceutical company. "Spontaneous recognition programs are growing and have become an organized, recognized and publicized part of the culture," reports a respondent from an electronics firm with a long-standing quality process.

Just as corporate policies on recognition vary, so does the terminology used to describe this activity. Many companies use the terms recognition and reward interchangeably. Quality expert J.M. Juran uses *recognition* to denote "public acknowledgment of superior performance," suggesting that such performance is voluntary. A company's *reward* system relates to "mandated work implied in the basic employment contract."[1] In this report, "recognition" is used as an umbrella term to signify the process by which a company reinforces employees' quality achievement. "Award," rather than "reward," is used to denote alternate manifestations of recognition: celebrations, plaques, pins, certificates, complimentary tickets, dinners or the like. However, not every activity covered by this usage of "recognition" and "award" is by definition voluntary. For example, some firms recognize employees for completion of quality training or participation on a team or task force—activities which may or not be voluntary.

As experts suggest, effective recognition requires that awards be of value to recipients. One way to find out what employees value is to ask them, as Allstate Insurance Company did in a recent employee study. The company learned that "timely and genuine management recognition" topped the list, followed by cash, peer recognition and noncash—but tangible—recognition. At Pennzoil Products Company, employees' responses indicate that instant recognition, "which takes into account their own unique behavior patterns and likes and dislikes," is the most effective. The company's managers receive written guidelines to remind them of employee preferences and are counseled that "employees will be more receptive to formal, organization-wide programs if they believe that the company really cares about them on a personal, day-to-day basis."

In a recent Conference Board survey of 158 firms with a TQM process, the vast majority of respondents had at least one award program linked to quality. When making a choice between offering cash and noncash awards, more companies chose *noncash*, especially those in the early stages of TQM implementation. The older a firm's TQM process is, the more likely it is to use a *combination* of cash and noncash rewards. Few

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[1] See J.M. Juran, "Strategies for World-Class Quality," *Quality Progress*, March, 1991.

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Table 1: Linking Recognition to the Management Development Program

Grouped by Industry

	Management Development Emphasizes Recognition		*Process Used*				
	Percent	*Number*	*Orientation*	*Courses*	*Visits to Other Companies*	*Mentoring*	*Other*
Manufacturing:							
Durable Goods	65%	22	27%	91%	36%	18%	4%
Nondurable Goods	58	14	50	86	28	43	21
Total Manufacturing	62	36	36	83	33	28	11
Service:							
Financial Services	67	12	50	92	–	17	–
Other Services	77	10	40	60	30	20	10
Total Services	71	22	45	77	14	18	4
Total (All Companies)	65	58	40	81	26	24	9

companies offered *only* cash awards.[2] The current study focuses on noncash recognition, but also discusses its relationship to other types of quality incentives.

Melding Recognition With the TQM Process

If a recognition program is to be effective, recognition-givers must first understand how to reinforce employee behavior and then be encouraged to do so. As with other aspects of quality, strong leadership is a prerequisite for effective recognition. Eight out of ten participants in this study report that top management strongly supports the TQM process. One indicator of top-level resolve regarding recognition is that management development programs in two-thirds of responding firms emphasize recognition's importance as a management tool. Most often this is done in internal courses or workshops. Nearly 25 percent of firms, however, address the role of recognition in orientation for new managers, and about 15 percent promote it through mentoring programs or by encouraging managers to visit companies with successful programs. The largest firms (10,000 or more employees) are more likely to use mentoring or company visits than smaller firms.

Patterns in use of management development to spotlight recognition vary by industry, work force size and the age of the TQM process. Service firms are somewhat more likely than manufacturers to integrate recognition into management development. But service firms rely primarily on internal courses, while manufacturers use a greater variety of techniques to achieve this end (see Table 1). The more mature the TQM process and the larger the work force, the more likely a company is to integrate recognition and reward into management development through a variety of techniques, rather than relying solely on classroom training (see Table 3, page 15, and the Method for a profile of participants by the age of TQM process).

Another way to bring the recognition process into the quality mainstream is to tie awards to internal self-assessment for groups, whether teams or company divisions. For example, the criteria for the Malcolm Baldrige National Quality Award are popularly used as a self-assessment tool. More recently, companies have used criteria for other awards issued by states, professional associations, government agencies and the like (see Appendix for a further discussion of these awards). Two examples illustrate alternate routes:

- Tandem Computers Incorporated's Quality Recognition Program for teams is designed to "put quality actions to the test." Either a team member or someone familiar with the team's work may submit a nomination for the award. The evaluation process is patterned after that of the Baldrige Award (see Exhibit 2 on page 14).
- North American Philips Corporation has a Quality Improvement System (QIS) Award program for operating divisions, manufacturing facilities and functional groups, which is based on a self-assessment form of its own design. There are four awards—each covers a separate phase with a defined set of criteria. The phases are: awareness and commitment; organization and planning; implementation; and recognition and renewal. The company expects that ultimately every operation should win an award for every phase.

  At North American Philips, upon completion of its self-assessment, an operating unit submits the application to its Quality Steering Committee, which makes the award nomination. The application is then forwarded to the corporate Quality Department, which reviews it to confirm eligibility. Final selections are made by a Peer Recognition

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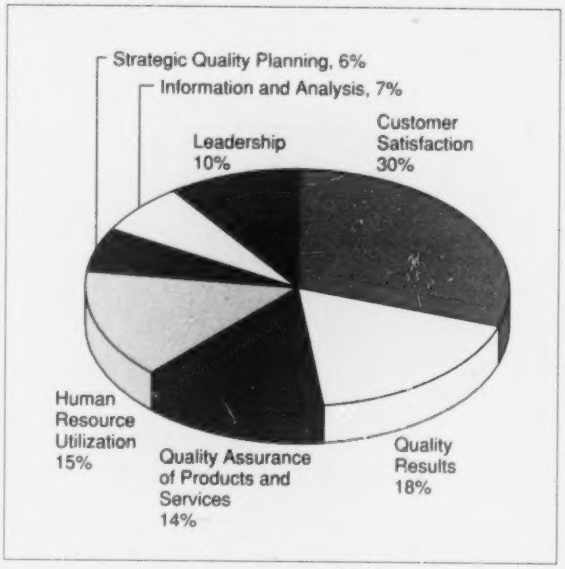
[2] See Kathryn Troy, *Employee Buy-In to Total Quality*, The Conference Board, Report No. 974, 1991.

Exhibit 2: Nomination Criteria for Tandem's President's Quality Award

To be eligible for the President's Quality Award, teams must meet the following criteria:

- **Leadership.** Demonstrate the practice of building quality values into planning, goal setting and performance reviews.
- **Information and Analysis.** Analyze quality-related information to support quality planning, performance reviews and improvement in processes, products and services.
- **Strategic Quality Planning.** Integrate quality-improvement goals into their short-term and long-term business plans.
- **Human Resource Utilization.** Include quality measures in performance goals, participate in group problem solving, and develop quality training and education plans.
- **Quality Assurance of Products and Services.** Demonstrate the practice of evaluating products and services and encourage continuous quality improvement.
- **Quality Results.** Compare quality levels to those of competitors or business units with similar functions.
- **Customer Satisfaction.** Understand customer requirements and the team's level of service, responsiveness and customer satisfaction.



Percentage of Award Categories.

Measuring the effectiveness of products, services and processes and comparing team results to those of other industry leaders are critical steps in the quality-improvement process. This use of measurement and benchmarking is the focus for the above criteria. These criteria are from Tandem's *Quality Manual.*

Committee of five to seven quality improvement managers drawn from the company's operating divisions. See Exhibit 3 for examples of the documentation required at each phase.

Nearly half the respondents say their award program is a self-assessment tool; this practice is more pronounced among service firms. Among manufacturers, producers of nondurable goods lag behind makers of durables in using this technique (see Table 2).

Nondurable manufacturing firms make up the majority of respondents with a TQM process five- to seven-years old; this group is also the exception to the pattern of progression in Table 3. In general, the more mature the TQM process, the more likely the award program will be linked to internal self-assessment. Similarly, the longer the company has awards in place, the more likely it is to tie at least one to self-assessment.

Of firms reporting a positive employee response to their recognition program, twice as many are likely to use awards for self-assessment as are the small number of firms with limited or negative employee response. Thus, recognition not only affirms and reinforces desired employee behavior, it can also help drive the TQM process by sparking internal self-assessment and continuous improvement.

Table 2: Use of Quality Award Criteria for Internal Self-Assessment

Grouped by Industry

	Total Number of Companies	*Number Doing Assessment*	*Percent*
Manufacturing:			
Durable Goods	30	15	50%
Nondurable Goods	21	9	43
Total Manufacturing	51	24	47
Service:			
Financial Services	12	7	58
Other Services	14	7	50
Total Services	26	14	54
Total (All Companies)	77	38	49

Exhibit 3: Documenting Self-Assessment at North American Philips Corporation

Examples of good documentation include:

Phase I : Awareness and Commitment

- Copy of the Quality Policy
- Samples of Operation newsletter with QIS articles
- Agenda or Minutes of Operation Review with QIS topics
- Cost of Quality
- Question and Answer booklets about QIS

Phase II: Organization and Planning

- Copies of QIT's plans and Element Plans
- Samples of tracking systems and attained goals
- Evidence of meeting consistency
- Status reports

Phase III: Implementation

- Copies of Performance Indicators accompanied by an explanation of their relevance to the business objectives and deployment through the organization
- Description of the PICS system and how it is functioning
- Monitor Chart samples, including photos of charts in place
- Documentation of corrective action and resulting improvements

Phase IV: Recognition and Renewal

- Description of the local award program (& samples)
- Documentation of Management review of Monitor Charts and other quality improvement activity (e.g., minutes of meeting or a newsletter article)
- Employee survey on QIS (and results of survey)
- Training program and Renewal Training plan
- Customer surveys (and results)

Documentation should not be confined to these examples. They are only meant to illustrate the type of material that could substantiate any assertion of an improvement step that has been implemented, is functioning consistently, and producing satisfactory results.

Table 3: Using Quality Award Criteria for Internal Self-Assessment

Grouped by Age of TQM Process

Years TQM Process is in place:	*Total Number of Companies*	*Number Doing Assessment*	*Percent*
8 years or more	13	8	60%
5 to 7 years	23	8	35
3 to 4 years	26	15	54
0 to 2 years	14	6	43
Total	76	37	49

Designing and Administering A Noncash Recognition Program

Getting started on quality recognition requires that executives pose and answer a battery of questions. Responses to this study suggest some commonalty in approaches to design and administration, but also some degree of diversity. The preliminary "how," "who" and "what" questions include:

- How should we gather information about program content, design and administration?
- Should we have formal as well as informal recognition?
- How many formal programs should we have and how much will they cost?
- Who will administer the formal program?
- What activities and people will be eligible?
- Who will the recognition-givers be?
- What form will recognition take?

Gathering Information

Prior to designing or reworking their noncash reward and recognition program, respondents gathered data from a variety of sources about what elements to include. Surveys of, or visits to, other companies are a primary source, used by two-thirds of firms, especially those with a relatively new TQM process. Over half of the firms rely on trial and error and about half attend outside seminars and workshops to learn about recognition programs. Surveying employees or hiring a consultant are among the other options. Just under half of the firms have surveyed their employees. This practice is more prevalent among companies that have a TQM process in place for a few years. Consultants have been used by about a quarter of respondents, with service firms more likely than manufacturers to seek such assistance (see Tables 4A and B).

Table 4: Gathering Information to Design a Noncash Award Program

A. Grouped by Industry	*All Companies (96)*	*Manufacturing (62)*	*Service (34)*
Sources of Information:			
Surveys/visits to other companies	65%	68%	59%
Trial and error, experience over time	56	53	62
Outside seminars/workshops	49	47	53
Internal employee surveys	45	35	62
Use outside consultant	25	19	35
Other	16	16	15

B. Grouped by Age of TQM Process	*0 to 2 Years (22)*	*3 to 4 years (34)*	*5 to 7 years (24)*	*8 years or more (15)*
Sources of Information:				
Surveys/visits to other companies	50%	79%	62%	53%
Trial and error, experience over time	45	44	67	80
Outside seminars/workshops	45	56	54	33
Internal employee surveys	23	56	42	53
Use outside consultant	23	21	33	27
Other	9	15	17	27

Table 5: Industry Profile (Numbers are Medians)

	Age of TQM Process (Years)	*Age of Non-Cash Award Program (Years)*	*Number of Award Programs*			*Annual Budget*	*Noncash Awards Percent Eligible*	
			Cash	*Noncash*	*Total*		*Managers*	*Nonmanagers*
Manufacturing (N = 62):								
Durable Goods	3	4	1	2	4	$25,000	10%	10%
Nondurable Goods	5	4	1	1	2	50,000	10	20
Total Manufacturing	4	4	1	2	3	37,500	10	14
Service (N = 34):								
Financial Services	2	3	1	2	3	40,000	7	25
Other Services	4	6	1	2	3	151,000	10	15
Total Services	3	4	1	2	3	80,000	10	20
Total (All Companies)	3	4	1	2	3	50,000	10	17

Table 6: Number of Award Programs

Grouped by Age of Noncash Award Program (N = 85)

Age of Award Program	*Number of Companies*	*Total Number of Awards*					*Noncash*				
		1	*2*	*3 to 4*	*5 to 6*	*Over 6*	*Combination**	*1*	*2*	*3 to 5*	*6 or more*
1 year or less	10	50%	–	40%	–	10%	10%	60%	10%	10%	10%
2 to 3 years	25	24	28	16	24	8	20	24	24	32	–
4 to 5 years	18	39	11	11	6	33	11	44	–	22	22
6 to 7 years	15	20	7	33	13	27	20	20	27	7	26
8 years or more	17	12	12	12	35	29	6	12	29	23	29

* One award with both a cash and noncash component.

Learning from trial and error and employee survey responses may be important elements in the success of a noncash award program. The dozen firms reporting a limited or negative employee response to their award program were much less likely to take these steps than companies that reported a positive employee response.

Nuts and Bolts Concerns

Due to the design of the questionnaire for this survey, companies most likely to respond have a formal award program as part of their recognition process. In most cases, these programs coexist with informal recognition. Typically, respondents have more than one quality award program, and quality awards are generally administered separately from other company awards. In just under half of the companies, administration is handled by someone in the quality function. Among the remaining firms, responsibility is widely dispersed. Budgets vary with the number of programs and employees recognized, but the median expenditure is $50,000. The prevailing practices are as follows:

Number of award programs: On average, respondents have three quality award programs, one cash and two noncash (see Table 5). The noncash program is about four years old, and the number of award programs tends to grow over time. For example, only 20 percent of firms with new noncash programs have three or more awards, compared with over 50 percent of the oldest (see Table 6). For firms with cash awards, the pattern is similar. The exception is among those companies with the oldest programs—over 40 percent have no cash awards. In some firms, a noncash award program predated the quality process, but was adapted or expanded to include quality achievement (see Table 7 on page 18).

Administration: At least 80 percent of firms that have award programs in areas other than quality say that quality awards are administered separately. Just over half of the firms report that the quality function is responsible for the awards program. In the remaining 47 percent of firms responsibility is scattered among a broad array of functions. Ten percent place responsibility with human resources. About 5 percent report that responsibility varies with the business unit or division,

Table 7: Age of Noncash Award Program (N = 86)

Years TQM Process Is in Place	*Number of Companies*	*1 or Less*	*2 to 3*	*4 to 5*	*6 to 7*	*8 to 10*	*Over 10*
8 years or more	14	–	7%	7%	29%	36%	21%
5 to 7 years	24	–	21	37	33	8	–
3 to 4 years	32	22	44	16	3	3	12
0 to 2 years	16	25	31	25	12	6	–
Total	86	13	29	22	17	10	8

Table 8: Quality Awards Administered Separately From Other Award Programs

Grouped by Size of Employee Population

	Number of	*Administering Separately*		*Department Administering*		
	Companies	*Number*	*Percent*	*Quality*	*Human Resources*	*Other*
Under 4,000	19	17	89%	40%	13%	47%
4,000 to 10,000	16	13	81	54	–	46
10,000 to 30,000	20	15	79	47	20	33
30,000 or more	21	16	76	69	6	25
Total	76	61	80	53	10	37

Table 9: Budget for Noncash Award Program

Grouped by Size of Employee Population (N = 63)

	Median Budget	*$20,000 or Less*	*$20,000 to $75,000*	*$75,000 to $150,000*	*Over $150,000*
Under 4,000	$ 29,900	43%	24%	24%	9%
4,000 to 10,000	50,000	31	23	23	23
10,000 to 30,000	200,000	27	20	–	53
30,000 or more	625,000	21	29	21	29
Total (All Companies)	50,000	31	24	18	27

and a similar number say that teams or committees take charge of recognition. Smaller percentages identify operations, sales, consumer affairs, or other functions as the source of recognition. Large companies (based on number of employees) are less likely to administer quality recognition separately from other award programs than are smaller firms, but those that do so are more likely to place the administrative responsibility in the quality function (see Table 8).

Size of program and budget: In the vast majority of companies, all managers and nonmanagers are eligible for awards, and about 10 percent of managers and 17 percent of nonmanagers receive them. The median budget for 67 respondents reporting these data is $50,000, but manufacturers report about $37,000, while service firms record $80,000 (see Table 5). The typical business unit budget is $45,000, while at the corporate level the median is $60,000.

As the size of the employee population grows, the *proportion* of managers and nonmanagers receiving rewards remains relatively stable; however, as might be expected, the *budget* expands. Among the smallest firms (under 4,000 employees) the median budget is $29,900, while among the largest (30,000 or more employees) it is $625,000. Larger budgets also signify greater numbers of award programs or the move to a combination cash/noncash award (see Tables 9 and 10). Experts suggest that the most effective recognition process has a wide reach, and one way to achieve this is to add award programs. The more programs respondents report, the greater the likelihood that the percentage of employees receiving awards is growing (see Table 11 and Chart 1).

Table 10: Number of Noncash Award Programs

Grouped by Size of Budget

Budget	*Number of Companies*	*Combination*	*1 to 2 Awards*	*3 to 5 Awards*	*6 or More Awards*
Under $20,000	19	26%	58%	10%	5%
$20,000 to $75,000	16	–	69	12	19
$75,000 to $150,000	11	–	46	27	27
Over $150,000	17	29	47	23	–
Total	63	16	55	17	11

Table 11: Participation Rate Grows With Number of Award Programs

	Managers Receiving Awards				*Nonmanagers Receiving Awards*			
Number of Noncash Award Programs	*Number of Companies*	*1 to 5*	*6 to 10*	*Over 10*	*Number of Companies*	*1 to 5*	*6 to 10*	*Over 10*
Combination*	9	22%	22%	55%	11	18%	–	82%
1 to 2 Awards	30	57	20	23	32	44	25%	31
3 to 5 Awards	17	35	29	35	19	21	21	58
6 or More Awards	11	18	27	55	11	18	9	73
Total (All Companies)	67	40	24	36	73	30	18	52

* One award with both a cash and noncash component.

Identifying Award Recipients

Most respondents indicate that more than one party is involved in identifying award recipients. For example, a nomination may be made by a supervisor or peer and forwarded to a recognition committee for final selection. With a high level award, such as one sponsored by a firm's president or chairman, a top officer may make the final selection (see Exhibit 4 on page 20 for alternate practices). Respondents say supervisors, senior managers and peers are most often involved in the awards process. In firms with just one award, nearly 80 percent say senior managers identify recipients and 60 percent involve supervisors and/or peers. In companies with six or more awards, supervisors and peers are key in over 80 percent of the firms and senior management in about 70 percent (see Table 12A on page 20).

Overall, executives other than top management or an immediate supervisor identify recipients in at least 50 percent of the companies; subordinates and customers do so in about 40 percent of the firms. Involvement of these groups (with the exception of subordinates) tends to increase over time (see Table 12B). Service firms, especially financial service companies, are more likely to use peer selection than are manufacturing firms. Customers are involved in nominating awardees in less than

Chart 1

Companies Reporting Growth In Award Eligibility

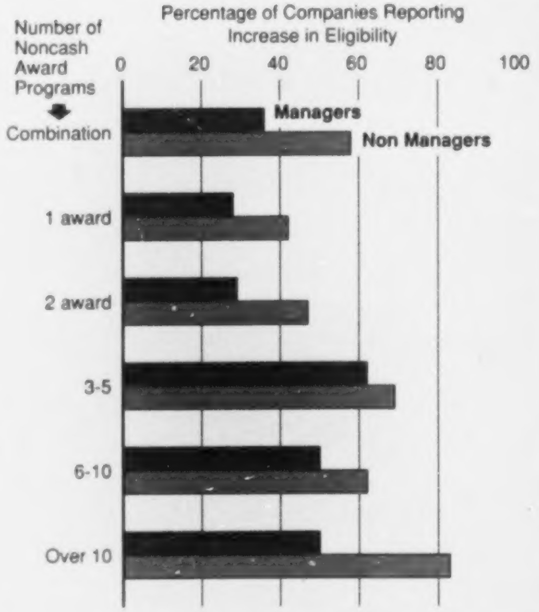


Table 12: Selecting Award Recipients

A. Grouped by Number of Awards

Number of Awards	Number of Companies	*Person/Group Making Award Nomination* Senior Management	Supervisor	Other Executives	Peers	Subordinates	Customers	Other
Combination*	14	57%	79%	50%	71%	57%	43%	7%
1	26	77	61	46	58	31	35	8
2	18	67	78	56	72	50	22	22
3 to 5	19	74	74	63	58	37	47	32
6 or More	14	71	100	64	86	43	57	21
Total	91	70	76	55	67	42	40	18

* One award with both a cash and noncash component.

B. Grouped by Age of Noncash Award Program

Age of Noncash Award Program	Number of Companies	Senior Management	Supervisor	Other Executives	Peers	Subordinates	Customers	Other
1 year or less	13	54%	54%	23%	54%	23%	38%	23%
2 to 3 years	25	80	80	44	60	48	32	28
4 to 5 years	19	53	68	58	74	21	32	10
6 to 7 years	15	73	73	67	73	60	53	13
8 years or more	17	82	94	76	76	47	47	12
Total	89	70	75	54	67	40	39	18

C. Grouped by Industry

	Number of Companies	Senior Management	Supervisor	Other Executives	Peers	Subordinates	Customers	Other
Manufacturing:								
Durable Goods	37	73%	70%	46%	57%	30%	19%	22%
Nondurable Goods	25	68	88	68	64	44	44	8
Total Manufacturing	62	71	74	55	60	35	29	16
Service:								
Financial Services	19	63	74	58	84	42	53	10
Other Services	15	68	73	47	60	53	53	33
Total Services	34	65	73	53	73	42	53	21
Total (All Companies)	96	69	74	54	65	40	37	18

Exhibit 4: Who Identifies Award Recipients? (Excerpts from Company Brochures)

Anyone, With a Review (Allstate Insurance Company)

Who Nominates: Any Employee.

Nomination Procedure: Nominator submits written nomination form to his/her manager or supervisor.

Approval Process:

- Manager/Supervisor gives nomination to Quality Improvement Team (QIT) Recognition Step Sponsor*
- QIT Recognition Step Sponsor* gets approval of nominee's manager who secures local approvals
- QIT Recognition Step Sponsor* submits approved nomination to appropriate committee

*or designated alternate

Note: Allstate has multiple award programs and procedures differ. The process outlined above is for the company's highest award.

A Supervisor (Society Bank)

The nomination application must be completed by the award nominee's immediate supervisor. It is then forwarded to the managing officer and senior division head for final approval. The approved nomination applications are forwarded to Service Quality Development for processing.

The Chairman (NYNEX)

Final selection will be at the sole discretion of the Chairman, based on the recommendations of an intercompany team of Quality Professionals. Nominations are submitted via the Quality Director of each company for approval of the President or Corporate Vice President. These nominations will then be forwarded to the Corporate Director, Quality Research & Support, as representative of the NYNEX-wide Quality Council(s) for evaluation by the selection committee.

Table 13: Activities Eligible for a Noncash Award

A. *By Age of Award Process*

	(N = 96)	*(N = 89)*				
Award-Eligible Activities	*All Companies*	*1 yr. or less*	*2 to 3 yrs.*	*4 to 5 yrs.*	*6 to 7 yrs.*	*8 yrs. or more*
Outstanding Achievement	77%	77%	80%	68%	80%	88%
System/Process Improvements	71	61	76	79	73	76
Completion of Quality-Related Activities*	61	31	68	74	67	70
Innovation	57	38	68	53	60	71
Employee Suggestions	50	23	48	68	47	65
Performance Based on Defined Goals	49	38	36	53	87	47
Leadership	49	31	44	47	67	65
Problem-Solving Skills	47	38	52	42	67	41
Certification as Instructor	21	23	24	16	13	29
Mentoring/Teaching/Facilitating	22	–	16	32	27	29

B. *By Industry* *(N = 96)*

	Manufacturing (N = 62)			*Service (N = 34)*		
Award-Eligible Activities	*Total*	*Durables*	*Nondurables*	*Total*	*Financial*	*Other*
Outstanding Achievement	79%	84%	72%	73%	79%	67%
System/Process Improvements	79	81	76	56	63	47
Completion of Quality-Related Activities*	71	81	56	44	37	53
Innovation	60	62	56	53	68	33
Employee Suggestions	48	43	56	53	68	33
Performance Based on Defined Goals	52	49	56	44	53	33
Leadership	45	43	48	56	74	33
Problem-Solving Skills	52	62	36	38	53	20
Certification as Instructor	24	22	28	15	10	20
Mentoring/Teaching/Facilitating	26	27	24	15	10	20

C. *By Number of Noncash Awards* *(N = 91)*

Award-Eligible Activities	*Combination***	*1 Award*	*2 Awards*	*3 to 5 Awards*	*6 or more Awards*
Outstanding Achievement	79%	61%	100%	84%	79%
System/Process Improvements	64	65	72	89	71
Completion of Quality-Related Activities*	64	65	39	74	79
Innovation	43	50	61	74	71
Employee Suggestions	43	35	44	68	71
Performance Based on Defined Goals	50	31	50	63	71
Leadership	36	42	56	47	71
Problem-Solving Skills	57	50	39	53	43
Certification as Instructor	7	23	6	32	36
Mentoring/Teaching/Facilitating	14	11	17	26	50

* For example, service on task force; training.

** One award with both a cash and noncash component.

20 percent of makers of durable goods, compared with 44 percent of producers of nondurable goods and 53 percent of service companies (see Table 12C). Firms reporting a positive employee response to their awards program are much more likely to use peer recognition and somewhat more likely to involve supervisors in the nomination process than are companies reporting a limited or negative employee response.

Award-Eligible Activities

Companies stress that the opportunities for informal recognition are limitless. But formal programs usually focus on a few key areas. Outstanding achievement is the most popular award criterion used by respondents. As Table 13A indicates, nearly 90 percent of firms with the oldest award programs use this criterion. In some cases, outstanding achievement awards predated introduction of a TQM process and have been extended to include quality activities. Other award-eligible activities used by half or more of the respondents include: system/process improvement; completion of quality-related activities, such as training or service on a task force; innovation; and employee suggestions.

In nearly half the firms, awards are given for performance based on defined goals, leadership, and problem-

Exhibit 5: What Activities Are Eligible for Awards? (Excerpts from Company Brochures)

Outstanding Achievement (Chrysler Corporation)

Candidates nominated for Corporate recognition must meet one or more of the following criteria. Outstanding:

- Corrective action activity
- Process/operation improvement
- Savings or waste reduction
- Accomplishment of task
- Methods/practices innovation
- QIP/PQIP Champion*
- Contribution to improved customer satisfaction
- Civic, charitable or community service

The following criteria should also be used to guide candidates selection:

- An "outstanding" work-related achievement implies effort above and beyond normal job responsibilities.
- The more senior the members of a team/group the more outstanding the achievement should be to receive award consideration.

* Quality Improvement Process

Process Skills (Allstate Insurance Company)

Must perform in a manner that demonstrates the four absolutes of quality. For example:

- Specific reduction of the number of nonconformances in a process
- Specific example of the implementation of a prevention system
- Achievement of zero defects in a particular process
- Specific PONC** has been eliminated

Additional criteria for managers:

- Is a role model in learning, using, and teaching customer focused quality

** Price of Nonconformance

Innovation (Dun & Bradstreet Software)

Awards go to those individuals who introduce a new idea, breakthrough, method or device that results in tangible, positive benefits for D&B Software customers, both internal and external.

Leadership (The First National Bank of Chicago-Cash Management Services)

The award is given annually to the employee whose leadership has made an outstanding contribution to quality/service excellence. He/she must have demonstrated leadership based on the following specifications:

Doing the *right things...*

- Evaluating all options thoroughly.
- Making wise decisions no matter how difficult they are.
- Encouraging innovation.
- Inspiring participation and teamwork.

Doing *things right...*

- Demonstrating a high level of personal integrity.
- Showing courage in making decisions, e.g., not trading off functionality for deadlines.
- Being uncompromising in pursuing quality.
- Sharing recognition of success.

Doing the right things right the *first time*.

solving skills. In a smaller group, about 20 percent of responding firms, certification as an instructor or activities such as mentoring, teaching and facilitating make employees eligible for awards (see Exhibit 5 for a sample of statements from award brochures).

For manufacturing, outstanding achievement, system/process improvement, and completion of quality-related activities form the top three award categories. Almost as great a percentage of service firms as manufacturers place outstanding achievement in the top spot. System/process improvement is second in both industry sectors, but nearly 80 percent of manufacturers make awards in this area, compared with about 55 percent of service companies. Manufacturers are less likely to give awards for leadership than are service firms, but overall they make a broader array of activities eligible for awards (see Table 13B).

Some categories of activity tend to gain eligibility as more awards are added or as the award program ages. Employee suggestions, innovation, leadership, and mentoring/teaching/facilitating activities are among those likely to be added. Based on the age of the award program, patterns are less pronounced, but leadership, mentoring and related activities appear to grow in popularity over time (see Tables 13A and 13C). Firms reporting a negative or limited response from employees tend to stress outstanding achievement; they put much less emphasis on leadership or completion of quality-related activities than is the case among companies reporting a positive employee response.

If It's "Noncash," What Is It?

Proponents of noncash awards suggest that the key to using recognition effectively is to make such occasions memorable. Among respondents, banquets, ceremonies and celebrations are in the top four types of recognition. These are often major company events, held at different

Table 14: Recognition Alternatives (N = 95)

		Eligibility				
	Percent Using Incentive	*Individuals and Groups*	*Individuals Only*	*Groups Only*	*None*	*Incentive is Part of Formal Award Program*
Company Recognition (Bulletin Board, Employee Publication, etc.)	96%	75%	15%	6%	4%	63%
Personal Letters/Notes of Commendation	89	68	18	3	11	39
Symbolic Awards:						
Plaques/Medallions	82	61	13	7	18	64
Certificates	76	59	15	2	24	56
Jewelry or Other Mementos	49	38	8	2	51	34
Other	18	12	5	–	82	18
Company Banquets and Ceremonies	82	57	13	11	18	60
Other Special Occasions	69	55	8	5	31	34
Face-to-Face Interaction With CEO	71	46	17	8	29	41
Complimentary Tickets to Sports/Cultural Events	46	28	17	1	54	19
Training/Educational Opportunities	42	26	12	3	58	18
Special Assignments (Task Forces, Speeches, etc.)	33	18	15	1	67	10
Work-Related Travel Opportunities	30	16	13	1	70	12
Enriched Work Assignments (Job Rotation, Stretch Projects)	30	15	16	–	70	12
Improvements in the Work Environment	15	5	8	1	85	5
Opportunities for Flexible Schedules	13	7	6	–	87	4
Vacation Trips	11	4	5	2	89	7

geographic locations and attended by senior management. For example, Xerox Corporation held its first "Teamwork Day" in one location in 1983 and has since expanded the event to 17 locations worldwide. Special photo-filled brochures are issued by some companies to mark the event and spotlight individuals, teams or company divisions and units who are award winners.

More than three-quarters of the firms recognize employees' quality achievement on bulletin boards or company publications, issue personal letters or notes of commendation, give symbolic awards such as plaques, medallions or certificates, and/or fete award recipients at company banquets or ceremonies. Roughly 50 to 70 percent include face-to-face interaction between award recipients and the CEO, special occasions (e.g., lunches or picnics), and symbolic awards (e.g., jewelry or similar mementos) in their array of quality incentives. Not every one of these incentives is considered part of the formal award program, but recognition on company bulletin boards or publications, symbolic awards, especially certificates, plaques and medallions, face-to-face interaction with the CEO and company banquets and ceremonies are most likely to be part of this package (see Table 14 and Exhibit 6 on page 24).

Smaller proportions of firms use additional incentives. Less than half use complimentary tickets or training and educational opportunities as recognition. At least 30 percent consider work-related travel opportunities and enriched work assignments (e.g., job rotation) or special projects/assignments (e.g., making speeches, working on task forces) part of their package. And 10 to 15 percent of firms say that vacation trips and offering employees flexible schedules or to make improvements in the work environment are used as quality incentives (see Table 14).

The age and number of awards programs have an impact on the diversity of the *formal* recognition portfolio. During the first year of the awards program, at least half of the companies emphasize public recognition (e.g., on bulletin boards), banquets and ceremonies, and the awarding of plaques. By two to three years, certificates are added. When the program is eight years or older, face-to-face interaction with the CEO is the practice in at least half the firms. Also, as more award programs are added, the use of symbols such as certificates, jewelry or other mementos and of special-occasion events increases (see Tables 15A and 15B on page 25).

Use of incentives by industry sector and employee size also varies. Service firms tend to emphasize a few types of recognition such plaques and medallions, and public acknowledgment on bulletin boards or in company publications. A greater percentage of manufacturers use these incentives and at least half also include certificates and company celebrations in their recognition portfolio. Among the smallest firms, at least half use the top three types of recognition described

Exhibit 6: How Are Award Winners Recognized? (Excerpts from company brochures)

At People's Bank, Connecticut:

All award winners receive the following:

- Recognition gift
- Newsletter announcement
- Letter from the President
- Managers' Meeting Announcement
- Letter for their Personnel File

In addition, Excellence and Quality Award winners are photographed and their photo and more detailed descriptions of their achievement are used in the employee newsletter.

At LifeScan, a Johnson & Johnson Company:

What do I receive if I earn a Quality Excellence Award?

Again, achieving a significant improvement in quality is rewarding in itself—it means you've helped our products or services better meet our customers' requirements, and in the process made your job and those of your co-workers more hassle-free.

In appreciation for your outstanding quality achievement, you'll receive a very special dinner for two at one of the Bay Area's finest restaurants, plus a sweater embroidered with the LifeScan quality logo. In addition, your photo will appear on *LifeScan's Quality Wall of Fame* along with photos of other award recipients.

Who will present the Quality Excellence Award? Where will it be presented?

Your Quality Excellence Award will be presented by one of LifeScan's officers at a Quarterly Employee Meeting. Your achievement will also be featured in a *LifeScan Monitor* article.

At Chrysler Corporation:

Chairman's Award

To recognize the *most outstanding* Divisional achievements, the Chairman's Award (trophy) will be presented to each recipient by the Chairman of Chrysler Corporation.

- For achievements involving two or more people, the Chairman's Award will be granted in the name of the team, each team member and the associated organization(s) on a team version of the Award. In the case of cross-functional teams, each organization will receive a copy of the team Award. If selected, the team will be asked to designate a representative to accept the Award at the ceremony. Chairman's Awards will be presented at a quarterly management meeting or other suitable occasion.

Other recognition for award recipients will include:

- A personal letter of congratulations, signed by the Chairman of Chrysler Corporation, with a copy to the Division Quality Council Chairman and/or operating unit head, and recipients manager.
- When the Chairman's Award is granted in the name of a team, each team member will receive the personal letter of congratulations mounted on a special plaque, as a memento of their achievement.
- Recognition through publication of an article and recipient/group photograph in the *Chrysler Times*.
- Recognition sponsored by the recipient's local organization such as newsletters and displays featuring the recipients photograph, nature of achievement, a copy of the Chairman's congratulatory letter, etc.

above while the largest expand their package to include certificates and face-to-face interaction with the CEO (see Tables 15C and 15D).

Expanding the Base

Overall, awards programs are encompassing rather than exclusionary. Respondents say that both individuals and groups are eligible for most of the noncash awards they give. A minority of firms, between 15 and 18 percent, report that only individuals are eligible for recognition tied to special occasions such as lunches, personal letters or notes of commendation, face-to-face meetings with the CEO, complimentary tickets, or enriched work assignments. In about 5 to 10 percent of companies, only groups participate in company banquets and ceremonies, face-to-face meetings with the CEO, receipt of plaques or medallions, recognition on bulletin boards or in company publications, or special occasions.

When groups are eligible, over half of the respondents recognize teams as well as company divisions or units with letters of commendation, publicity on bulletin boards or in company publications, and with plaques and medallions. Divisions and units are least likely to be included in receipt of such symbolic awards as jewelry and mementos and most likely to be recipients of letters of commendation or publicity on bulletin boards or in publications (see Table 14, and Table 16 on page 27).

Spreading the Word

For recognition and award programs to be effective, managers and employees need to understand how they work. Company magazines and newsletters are a major conduit of such information, announcing new programs, carrying recognition stories, and reminding employees and managers that the award programs exist. Some companies provide special guidelines for managers and many prepare an award program brochure (see Exhibit 7 on page 26).

Brochures may discuss an individual award or the entire awards program. For example, Allstate Insurance

Table 15: Most Frequently Used Elements of a Formal Recognition Program

A. Grouped by Number of Noncash Awards

	*Combination** *(N = 14)*	*1* *(N = 26)*	*2* *(N = 18)*	*3 to 5* *(N = 19)*	*6 or More* *(N = 14)*
Company Recognition (Bulletin Board, Employee Publication, etc.)	64%	58%	89%	68%	50%
Personal Letters/Notes of Commendation	57	27	44	37	50
Symbolic Awards:					
Plaques/Medallions	50	69	83	63	64
Certificates	50	50	67	63	64
Jewelry or Other Mementos	50	23	33	37	43
Company Banquets and Ceremonies	64	58	72	58	64
Other Special Occasions	43	19	39	42	43
Face-to-Face Interaction With CEO	36	38	50	47	43

* One award with a cash and a noncash component.

B. Grouped by Age of Noncash Award Program

	Years in Place				
	1 or Less *(N = 13)*	*2 to 3* *(N = 25)*	*4 to 5* *(N = 19)*	*6 to 7* *(N = 15)*	*8 or More* *(N = 17)*
Company Recognition (Bulletin Board, Employee Publication, etc.)	54%	72%	58%	67%	65%
Personal Letters/Notes of Commendation	38	44	32	47	41
Symbolic Awards:					
Plaques/Medallions	54	60	58	93	70
Certificates	46	68	53	73	53
Jewelry or Other Mementos	15	24	42	67	35
Company Banquets and Ceremonies	54	56	68	73	59
Other Special Occasions	15	36	42	27	41
Face-to-Face Interaction With CEO	23	44	42	47	53

C. Grouped by Industry

	All Companies *(N = 96)*	*Manufacturing* *(N = 62)*	*Service* *(N = 34)*
Company Recognition (Bulletin Board, Employee Publication, etc.)	62%	66%	56%
Personal Letters/Notes of Commendation	38	37	41
Symbolic Awards:			
Plaques/Medallions	63	69	53
Certificates	55	60	47
Jewelry or Other Mementos	33	32	35
Company Banquets and Ceremonies	59	66	47
Other Special Occasions	33	39	23
Face-to-Face Interaction With CEO	41	40	41

D. Grouped by Size of Employee Population

	Number of Employees			
	Under 4,000 *(N = 22)*	*4,000 to 10,000* *(N = 20)*	*10,000 to 30,000* *(N = 22)*	*30,000 or More* *(N = 23)*
Company Recognition (Bulletin Board, Employee Publication, etc.)	73%	65%	36%	70%
Personal Letters/Notes of Commendation	23	50	41	43
Symbolic Awards:				
Plaques/Medallions	50	60	68	70
Certificates	45	50	68	57
Jewelry or Other Mementos	27	25	50	30
Company Banquets and Ceremonies	54	60	68	61
Other Special Occasions	27	35	41	30
Face-to-Face Interaction With CEO	27	40	41	57

Exhibit 7: Communicating Recognition at Society Bank (Dayton, Ohio)

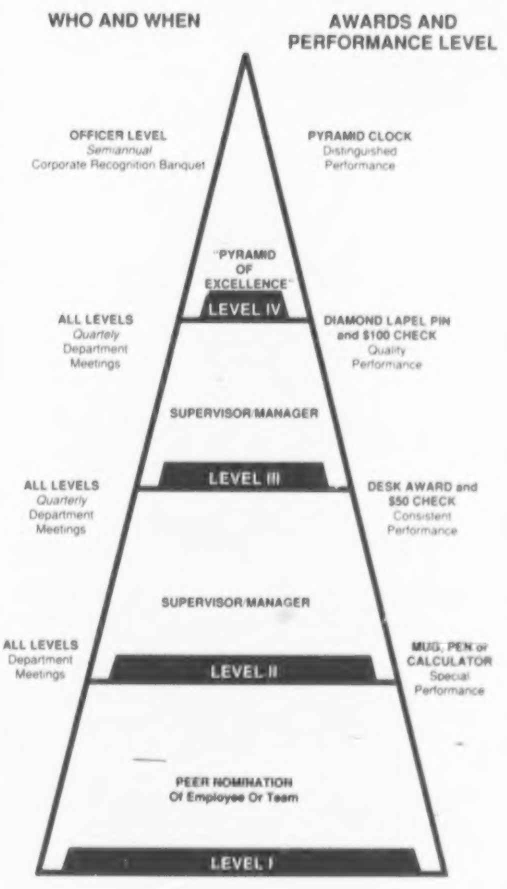
MANAGER'S SUCCESS TIPS

STEP I MAKING IT HAPPEN

- Once you become familiar with the **"One of the Best"** recognition process, start documenting who you want to nominate in your area using the appropriate nomination form(s).
- We recommend that you nominate your employees for Level I first, before you nominate an employee for the new Level II. However, if you do wish to nominate for Level II, please complete the Level II nomination form and the Employee Bonus Plan form for the issuance of the $50 check.
- Brainstorm on ways to make your anniversary kick-off meeting unique, enthusiastic and fun.
- Order an appropriate supply of recognition awards from Purchasing by completing the customized **"One of the Best"** order form.
- Make sure to plan your kick-off meeting so all employees can attend.
- Plan refreshments for your meeting.
- Notify your Senior Division Head of the time you plan to reintroduce the **"One of the Best"** recognition process.

STEP II THE KICK-OFF EVENT

- Decorate your area with **"One of the Best"** posters and balloons enclosed with your **"One of the Best"** promotional kit.
- Personally kick-off **"One of the Best."**
- Explain scope of the process. Discuss:
  - Meetings are being held corporate-wide in the Administrative and Support Staff areas.
  - Purpose of the recognition process.
  - Four recognition levels of **"One of the Best."**
  - Qualifying guidelines for each level.
  - Award nomination process.
  - Corresponding awards for each level.
- Distribute a **"One of the Best"** brochure to every employee present at the meeting.
- Advise that *Society Now* will include a quarterly insert devoted to the award recipients.
- Conduct your awards ceremony (Level I awards). The surprise of presenting an award(s) at the meeting will add to your meeting's excitement. (Make sure to describe to employees some of the specific examples/behaviors the award recipient elicited to warrant recognition).
- Distribute Level I peer nomination forms and encourage them to nominate deserving employees for recognition.


WHO AND WHEN
AWARDS AND PERFORMANCE LEVEL
OFFICER LEVEL
Semiannual
Corporate Recognition Banquet
PYRAMID CLOCK
Distinguished Performance
"PYRAMID OF EXCELLENCE"
LEVEL IV
ALL LEVELS
Quartely
Department Meetings
DIAMOND LAPEL PIN and $100 CHECK
Quality Performance
SUPERVISOR/MANAGER
LEVEL III
ALL LEVELS
Quarterly
Department Meetings
DESK AWARD and $50 CHECK
Consistent Performance
SUPERVISOR/MANAGER
ALL LEVELS
Department Meetings
LEVEL II
MUG, PEN or CALCULATOR
Special Performance
PEER NOMINATION
Of Employee Or Team
LEVEL I

"One of the Best" Process Overview

STEP III KEEP RECOGNITION ALIVE AND WELL

- Continue to conduct quarterly recognition ceremonies.
- Retain the names of recipients receiving a **"One of the Best"** award.
- Complete and submit a **"One of the Best"** status report for every quarterly recognition ceremony. Please attach photocopies of all completed Level II and Level III nomination applications.
- Continue to champion all various forms of recognition.

If you have a question concerning the **"One of the Best"** recognition process contact Recognition Administrator in Service Quality Development.

Table 16: Groups Eligible for Incentives/Awards

		Eligibility		
	Number of Companies	*Both Teams and Divisions/Units*	*Teams Only*	*Divisions/ Units Only*
Company Recognition (Bulletin Board Employee Publication, etc.)	78	54%	41	5
Personal Letters/Notes of Commendation	68	60	38	1
Symbolic Awards:				
Plaques/Medallions	66	50	42	7
Certificates	59	44	49	7
Jewelry or Other Mementos	39	33	61	5
Company Banquets and Ceremonies	66	44	47	9
Other Special Occasions	58	46	45	9
Face-to-Face Interaction With CEO	52	42	46	11

provides a matrix describing options for informal and formal recognition, including a performance bonus. The matrix summarizes the format, eligibility, requirements, nomination procedure and approval process. Company brochures for individual awards usually include similar information as well as a discussion of the purpose of the award. Applications may be part of the brochure or be available separately. One essential component of peer recognition is that it be made easy. At Alliant Techsystems, employees receive a packet of Post-it notes preprinted with the company's reward and recognition logo and the word "Thanks." In the space provided for comments, employees may send kudos to their associates for a job well done. When the supply of notes is exhausted, employees pick up more from their department administrator.

Program Reassessment and Renewal

Continuous improvement is as essential to recognition as it is to other total quality practices. At least half of the respondents to the study have evaluated their employees' receptivity to their noncash recognition program, with generally positive results. Participants also report that cash incentives can be used effectively to gain quality commitment among certain groups of employees. Thus, as the TQM process evolves, companies strive to meld recognition with other incentives, whether they be compensation, promotion or cash awards.

Just over half of the participants have evaluated employees' reception of their noncash recognition system. The older the awards process and the larger the work force, the greater the likelihood that an evaluation has taken place. Surveys are the most popular tool; 8 out of 10 firms use them with similar patterns occurring among manufacturers and service firms. In general, survey use increases with the age of the award program. About half of the companies use focus groups; service firms are heavier users of this technique than are manufacturers (see Table 17A, 17B and 17C). The data suggest that this technique may be employed every few years—perhaps as a supplement or alternative to survey work. Other methods (e.g., departmental meetings and management reviews) are used by about 15 percent of respondents, and the largest firms (30,000 or more employees) are the most likely to use them.

Employee response to noncash programs is positive in 65 percent of the firms. Less than 15 percent of respondents reported a limited or negative response. Executives who have actually evaluated employee responses—especially those who have conducted surveys—report a more positive employee reaction to noncash recognition than do those who have done no formal evaluation (see Table 18). Among factors lead-

Table 17: Evaluating Employee Satisfaction With Noncash Recognition

A. Grouped by Size of Employee Population

	Number of Companies	*Percent Evaluating Employee Response*
Under 4,000	20	55%
4,000 to 10,000	20	50
10,000 to 30,000	22	45
30,000 or More	23	74
Total	85	56

B. Grouped by Age of Award Process

	Number of Companies	*Percent Evaluating Employee Response*
1 Year or Less	11	9%
2 to 3 Years	24	50
4 to 5 Years	19	42
6 to 7 Years	15	87
8 Years or More	17	82
Total	86	56

C. Grouped by Industry

		Evaluation Method Used				
	Have Evaluated Employee Response	*Survey*	*Focus Group*	*Department Meetings*	*Senior Management Review*	*Other*
Manufacturing (N = 62)	56%	86%	43%	14%	17%	9%
Service (N = 34)	50	81	62	19	6	12
All Companies (N = 96)	54	84	49	16	14	10

Table 18: Employee Response to Noncash Recognition

	Number of Companies	Employee Response		
		Positive	Average	Limited/ Negative
Have Done Formal Evaluation				
Yes	50	76%	16%	8%
No	37	54	27	19
Used a Survey				
Yes	42	81	14	5
No	46	52	26	22
Used Focus Groups				
Yes	23	74	17	9
No	65	63	22	15

Table 19: Impact of Quality Incentives (N = 88)

	How Effective Is Incentive in Reinforcing Quality Commitment Among:					
	Senior Managers?		Middle Managers?		Nonmanagers?	
	Very	Negligibly*	Very	Negligibly	Very	Neglibly
Compensation Tied to Quality Performance	44%	13%	31%	17%	23%	27%
Promotion Tied to Quality Performance	33	29	37	15	31	20
Special Celebrations/Ceremonies	21	37	40	12	65	8
Cash Awards	26	48	23	31	43	23
Symbolic Awards (Noncash)	10	39	26	14	47	15
Enriched Work/Special Assignments	11	44	24	24	27	32
Training/Educational Opportunities	10	50	18	27	33	23

* The remaining companies found each incentive "moderately" effective.

ing to success, participants cite: employees helped plan and administer the program; management became involved and participated in public recognition; and criteria for the awards were highly specific, helping employees understand what behavior earned recognition. Factors leading to disappointment include the "limited reach" and uneven implementation of the awards program.

Noncash Recognition in Perspective

Some companies look upon recognition as part of a total package of incentives for quality achievement which includes compensation and promotion as well as company awards. Participants in this study were asked to assess how effective key incentives are among senior managers, middle managers and nonmanagers.

In the experience of respondents, compensation or promotion tied to quality performance are the strongest incentives among senior managers, who are usually the recognition-givers rather than recipients. However, responses suggest that such recognition as celebrations/ceremonies and cash awards rank third and fourth respectively among this group.

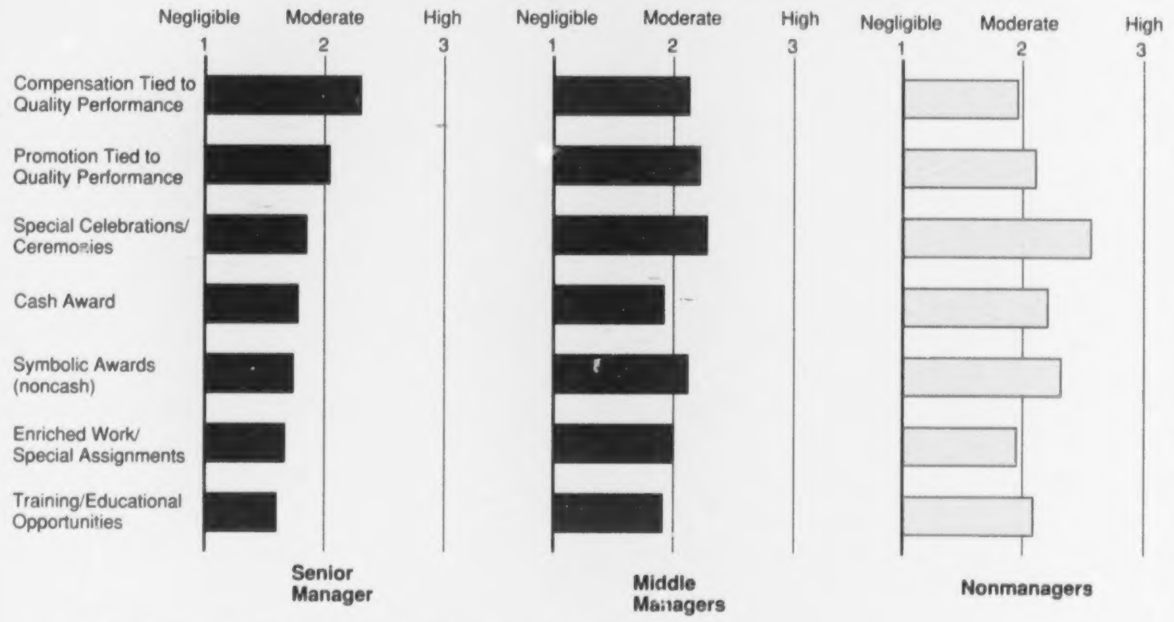
Participants believe that middle managers and nonmanagement employees are most responsive to the atmosphere of recognition created by company celebrations or ceremonies tied to quality. Tangible rewards—opportunities for promotion and increased compensation—fill the second and third spot for middle managers, followed by symbolic awards (e.g., pins, plaques, certificates). Symbols, cash awards and promotion opportunities hold second through fourth place for nonmanagers (see Table 19 and Chart 2 on page 30).

No strong patterns by industry are evident as to how respondents judge the effectiveness of the various incentives. The age of the TQM process, and in some cases the size of the work force, do appear to be relevant. Overall, ceremonies and symbols are important to middle managers and nonmanagers throughout the life cycle of the TQM process, but grow in importance among senior managers only after the process is in place about five years. Some disagreement about the impact of cash awards on middle and nonmanagers is

Chart 2

Reinforcing Commitment to Quality: Assessing Incentives

Effectiveness of Incentive with Managers & Nonmanagers*



* Participant responses were assigned weights, with "high" equal to three and "negligibly" equal to one, and were then averaged.

apparent in the early years of the TQM process, but such awards appear to become more effective as the process matures. Overall, about half of survey respondents have a cash awards program. Ties to compensation are believed to be very effective among senior managers at every stage of the TQM life cycle; they grow more important with other groups over time (see "Quality Incentives and TQM Maturity" on page 31).

The larger the size of the work force the more likely respondents are to rate compensation and promotion as highly effective with senior managers. These firms identify recognition (both ceremonies and symbols) and compensation as strong incentives for middle managers. At the lower end of the size spectrum, companies with less than 4,000 employees were the most skeptical. At least two-thirds of this group rated promotion, cash awards, ceremonies and symbols "low" as incentives for senior managers. Half gave promotion and cash awards a similar rating when applied to middle managers, and a third also consider ceremonies and symbols an inadequate incentive for the middle manager.

According to these smaller companies, ceremonies and celebrations are the most effective incentive with nonmanagers. Yet only half give such occasions a "high" rating, compared with 80 percent of executives in the largest firms. In just over a third of the smaller firms, cash and symbolic awards are considered effective with nonmanagers. Still, more than a quarter of the group give these incentives a low rating (see Table 20).

Opportunities for training and education or enriched work assignments were among the other noncash incentives rated by survey participants. Roughly three-quarters felt that these incentives were at least moderately effective in sparking quality achievement among middle managers. An equal proportion considered training and education a viable incentive with nonmanagers, and nearly 70 percent agreed that opportunities for enriched work or special assignments met this test. Less than half believed that such opportunities had an impact with senior managers, and about half judged training and education to be at least moderately effective with this group.

When asked to comment on the efficacy of the various incentives, the most hotly debated issue among respondents arose over the impact of cash versus noncash awards. Comments such as: "Money tends to be a limited, short-term motivator"; "Cash prizes are only good and remembered until the money is spent. Noncash endures"; "You cannot place a cash value on quality," suggest the tenor of the sentiment among

Quality Incentives and TQM Maturity

Based on their experience, respondents, who were primarily quality executives, indicate that whatever the age of a company's TQM process, ceremonies and celebrations are effective in promoting commitment to quality among middle managers and nonmanagers. Ceremonial occasions are more likely to be effective among senior managers when the TQM process is five years or older. Symbolic awards appear to be effective with nonmanagers throughout the life cycle of a TQM process, but their impact is stronger among middle or senior managers after the process has been in place at least five years.

About half of the respondents believe that the impact of cash awards on senior managers' commitment to quality is negligible; this appraisal holds regardless of the age of the company's TQM process. Over 40 percent of firms with a relatively new process (two years or less) consider the impact of cash awards negligible among middle managers, but as the process matures, such awards appear to have greater impact. Companies with the newest and oldest TQM process are the most skeptical about the benefits of using cash awards for nonmanagers. But about half of the firms with TQM in place for three to seven years report that cash awards are very effective with this group.

Company efforts to tie quality performance to compensation tend to start at the top and move through the ranks as the TQM process matures. Among firms with the newest process, at least half believe ties to compensation are very effective with top and middle managers, and about a third say this is true for nonmanagers. Over 80 percent believe that ties to compensation remain very to moderately effective in promoting TQM commitment among managers as the process approaches maturity (three to seven years), and at least 75 percent believe that this is also true among nonmanagers. However, in companies with the most mature process (eight years or older), 30 to 40 percent report that the impact on middle and nonmanagers is negligible. Less than 20 percent say that this is so for senior managers. In fact, executives in 63 percent of firms with programs of this vintage believe that ties to compensation are a very effective incentive for senior managers.

Table 20: Impact of Quality Incentives

Grouped by Size of Employee Population

A. Senior Managers (N = 61)

Number of Employees	*Compensation*		*Promotion*		*Cash Awards*		*Quality Award Ceremonies*		*Symbolic Awards*	
	High	*Low**	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*
Under 4,000	11%	22%	22%	67%	10%	80%	15%	69%	8%	67%
4,000 to 10,000	40	10	14	14	37	37	17	25	17	33
10,000 to 30,000	44	6	33	20	29	36	19	31	6	33
30,000 or More	67	13	43	21	25	42	30	25	6	29
Total	44	11	31	29	25	48	21	36	8	39

B. Middle Managers (N = 70)

Number of Employees	*Compensation*		*Promotion*		*Cash Awards*		*Quality Award Ceremonies*		*Symbolic Awards*	
	High	*Low**	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*
Under 4,000	11%	22%	25%	50%	17%	58%	20%	33%	15%	38%
4,000 to 10,000	33	–	57	–	40	10	43	7	21	7
10,000 to 30,000	28	28	33	13	13	33	39	6	21	5
30,000 or More	43	14	36	7	25	25	52	4	40	15
Total	30	18	36	16	22	33	40	11	26	15

C. Nonmanagers (N = 72)

Number of Employees	*Compensation*		*Promotion*		*Cash Awards*		*Quality Award Ceremonies*		*Symbolic Awards*	
	High	*Low**	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*
Under 4,000	9%	27%	12%	50%	38%	31%	50%	25%	36%	29%
4,000 to 10,000	22	11	50	–	44	22	71	–	43	14
10,000 to 30,000	37	37	40	13	50	25	53	5	45	10
30,000 or More	21	14	21	14	33	17	78	4	60	15
Total	24	24	30	19	42	24	64	8	47	16

* Companies responding "moderately" make up the difference between 100 percent and the sum of "high" and "low" percentages.

proponents of noncash reward and recognition. But advocates for the other side argue: "Cash sends a message about priority and reinforces management's message in a very visible way"; "Nonmanagers and middle managers feel that cash awards denote that an activity is significant to management"; "Recognition is important to everyone, cash awards are favored by nonexempt employees."

About 60 percent of respondents have linked quality to compensation, and some noted with pride that "performance compensation and total quality are all part of the system." Several firms also endorsed gainsharing and bonus plans: While "recognition is linked to a specific activity, gainsharing is determined by movement in overall plant indicators." Respondents also noted, gainsharing "is quite successful for getting people involved in improvement," and it is "especially successful when employees have an opportunity to participate in the goal-setting process." Bonus plans had impact when "tied directly to performance against objectives and quality-related results," and one respondent reported use of bonuses linked to scores on a customer satisfaction measurement.

There is probably no one best incentive or approach to recognition. A respondent from a pharmaceutical firm sums up one company's experience this way: "You have to look at what fits your culture. We benchmarked recognition and found that incentives that work well at other companies won't work here. Reinforcement must be tailored to the employees' environment."

Fine Tuning Recognition

When asked what was needed to improve recognition for quality performance in their company, respondents' prescriptions tended to vary with the age of their awards program:

Startup programs (new to two years) focus on securing top-level commitment, publicizing the program and assessing results. Respondents say they need to define the criteria, feature success stories, and help managers to understand that recognition is an important part of their job. "We need to use the program in the right way, making sure that we reward what we say we value," says a participant from a durable goods firm. Several firms with programs of about two years of age had evaluated their progress and made adjustments (e.g., expanding eligibility from individuals to teams, adding a cash component, or shifting from awards of merchandise to plaques or medallions).

At *"middle age,"* (three to seven years) companies stress expansion and consolidation. Typical among firms with a three- to four-year old program are such comments as: "Our goal is to expand recognition companywide and make it an accepted part of our culture." Recognition cannot be considered only a top management activity; it needs to become a tool of middle managers as well. Firms at this stage say they are more aggressive about "tying compensation, promotion and recognition to job performance for all job families."

As the formal recognition process cascades throughout the organization, the need for communication and training intensifies—especially in firms with a five- to seven-year old program. It is important to clarify award requirements for all employees, "explain the full diversity of the recognition vehicles in use," to publicize the awards, their criteria and winners, and to describe the specific performance that led to recognition. Managers need training not only in how to deliver reinforcement, but in the mechanics of setting expectations, measuring performance, providing feedback, and exercising accountability. As formal programs take hold, companies at this stage of development also place renewed emphasis on informal recognition—day to day instant praise and reward by supervisors as well as peer recognition.

The *elders* of the group (those with recognition programs in place for eight years or more) are preoccupied with the job of integrating recognition into the quality process and tying it more securely to compensation and promotion as well as to business outcomes. Typical comments from this group focus on the need to "make recognition part of the work process, not a distinct activity." Respondents hope to tie the recognition system to widespread use of quality measurements or to management/employee performance. They feel they need to "clarify the relationship between quality performance and business results" and "improve communication about how recognition is tied to business results." In some firms, process improvement is stressed as award eligibility moves beyond divisions or functions to encompass cross-functional teams.

How to Succeed

Like other successful processes, effective recognition requires a combination of inspiration and hard work. No formal recognition program can remain static and work effectively over the long term. Benchmarking can be helpful both at start-up and throughout the life cycle of formal recognition programs. But a firm's ability to learn from trial and error as well as from its employees' responsiveness to alternate forms of reinforcement is crucial to recognition's evolution and continuing success. Based on this study, the following guidelines may help companies maintain a viable quality recognition process:

Understand employees: Invest sufficient time in researching alternatives and understanding employees' concerns before launching a formal recognition process. Follow up periodically using employee surveys or focus groups to assess progress and make adjustments. Learning from other firms, preferably those with a similar employee base and corporate culture, or attending workshops on recognition may be helpful, especially if the company has had no other recognition program. Consider what your company has learned from employee surveys or past award programs about employee values and expectations. For example, prior award programs may have had a cash component and been popular with employees. What message will a noncash-only quality award program send? Alternatively, when employees have had little experience with other forms of recognition, their "just give us cash" response may be misleading.

Set objectives over time: The ultimate objective of many quality recognition programs is to spread the base so that growing numbers of employees, teams or other groups are receiving reinforcement from many different sources for a wide array of desired quality behaviors. Realizing this objective takes time. It is important to establish a combination of short, intermediate and long-term objectives.

Early in the TQM process, respondents chose to focus on recognizing employees for completing training, serving on teams or participating in other quality-related activities. Employee suggestions, outstanding achievement, and system or process improvements were also popular as recognition-worthy activities in early years. Respondents started with one or two award programs and added both eligible activities and award programs as their TQM and awards process matured. Peers and supervisors are often the recognition-givers early on, but many firms also involve top management or even establish a CEO or president's award. These awards not only give the recognition process visibility and feature the top executive as a role model for managers, they also can spur internal self-assessment. As the process matures, other executives, customers, and subordinates may be added to the list of recognition-givers.

Consider the investment: Recognition does not need to be costly. For many companies, the core of a noncash recognition program includes such inexpensive activities as acknowledging award winners on bulletin boards or in company publications, purchase of award symbols such as medallions or certificates, or organizing award banquets or other celebrations. The latter may involve at least a moderate investment, but appears to be a *sina qua non* for effective quality recognition.

Even when using cash awards, companies may control their investment by placing them at the pinnacle of the recognition pyramid, rather than giving them wide use as baseline recognition. Whatever the choice, there are associated costs, including training managers on the value of recognition, preparing and disseminating brochures and other award-related communiques, and investing manager and employee time in the self-assessment activities required to qualify for some awards.

Make recognition an integral part of the quality process: Recognition must be built around employee values, but it must also be effective in reinforcing a quality culture. In assessing recognition's success, respondents are seeking evidence that it actually reinforces the behavior necessary to sustain the TQM process. Moreover, as the TQM process matures, firms attempt to interweave recognition with compensation, promotion or other quality-related incentives. The ultimate objective is that recognition, like quality, will not only become part of the work process, but also "the way we do things around here."

Appendix:

Summaries of External Quality Award Programs

Compiled by Deanna L. Cinelli

In today's globally competitive business environment, companies from all sectors are beginning to realize that increased quality, productivity, and customer service are needed for survival. Total quality management is a process requiring cooperation, trust, an empowered work force, and a mutual understanding of organizational goals. The need to set criteria for these elements and to showcase organizations which attain world-class quality has led to the establishment of numerous award programs in the United States and abroad.

The Malcolm Baldrige National Quality Award represents the highest level of recognition that U.S. companies in the private sector can receive for their achievements in quality excellence. The interest in quality issues and concern with the nation's problem of declining productivity in the mid-1980s led to efforts by members of the U.S. Congress and other industry leaders to pass legislation for a national quality award. In 1987, President Reagan signed the Malcolm Baldrige National Quality Improvement Act named after the late Secretary of Commerce, Malcolm Baldrige.

The Baldrige Award Program encompasses a number of key elements which make up the Baldrige criteria (see box on page 35). These criteria have been organized into seven categories. Each category examines areas of quality management that are most likely to reveal characteristics of excellent companies. Many other state and international award programs use criteria based on those of the Baldrige Award. Three of these awards are described in the appendix and include the New York State Excelsior Award, the British Quality Award and the European Quality Award. Other U.S. quality awards which are based on Baldrige criteria not mentioned in the appendix are the North Carolina Quality Leadership Award, Minnesota Quality Award, Maine Quality Award and the Connecticut Quality Improvement Award. Other types of U.S. award programs specifically recognize business excellence in: the manufacturing industry; the computer software and services industry; the federal government; the aerospace industry; individuals and teams; and the application of quality control methods. (See box on page 36 for a brief description of these award programs.)

This appendix also includes presentations on five local, regional, national, and international quality award programs. It contains information on their objective(s), eligibility requirements, criteria, application process, judging process, categories and award winners. Also included are addresses for the sources of all quality award programs discussed.

The Malcolm Baldrige National Quality Award

1992 Examination Categories/Items			*Point Values*
1.0	**Leadership**		**90**
1.1	Senior Executive Leadership	45	
1.2	Management for Quality	25	
1.3	Public Responsibility	20	
2.0	**Information and Analysis**		**80**
2.1	Scope and Management of Quality and Performance Data & Information	15	
2.2	Competitive Comparisons and Benchmarks	25	
2.3	Analysis and Uses of Company-Level Data	40	
3.0	**Strategic Quality Planning**		**60**
3.1	Strategic Quality and Company Performance Planning Process	35	
3.2	Quality and Performance Plans	25	
4.0	**Human Resource Development and Management**		**150**
4.1	Human Resource Management	20	
4.2	Employee Involvement	40	
4.3	Employee Education and Training	40	
4.4	Employee Performance and Recognition	25	
4.5	Employee Well-Being and Morale	25	
5.0	**Management of Process Quality**		**140**
5.1	Design and Introduction of Quality Products and Services	40	
5.2	Process Mgmt.—Product & Service Production & Delivery Processes	35	
5.3	Process Management—Business Processes and Support Services	30	
5.4	Supplier Quality	20	
5.5	Quality Assessment	15	
6.0	**Quality and Operational Results**		**180**
6.1	Program and Service Quality Results	75	
6.2	Company Operational Results	45	
6.3	Business Process and Support Service Results	25	
6.4	Supplier Quality Results	35	
7.0	**Customer Focus and Satisfaction**		**300**
7.1	Customer Relationship Management	65	
7.2	Commitment to Customers	15	
7.3	Customer Satisfaction Determination	35	
7.4	Customer Satisfaction Results	75	
7.5	Customer Satisfaction Comparison	75	
7.6	Future Requirements and Expectations of Customers	35	
	TOTAL POINTS		**1000**

Other U.S. Quality Award Programs

The Shingo Prize—established in honor of Dr. Shigeo Shingo for his work in the development of the Toyota Production System and his work with just-in-time, quick changeover and waste reduction techniques in manufacturing. The Prize has been recognized by several American organizations such as the American Productivity and Quality Center, Health Care Manufacturers Association, National Association of Manufacturers, and Productivity, Inc. The two categories of the award are the Business Prize and the Research Prize.

ITAA Quality Award—established by the Information Technology Association of America to recognize significant quality achievements by ITAA members in computer software and services. The award is also patterned on the Malcolm Baldrige National Quality Award program. The four award categories are: the Total Quality Award for members with revenues of $50 million or more; Total Quality Award for members with revenues less than $50 million; Documentation/Training Materials Quality Award; and the Customer Support Quality Award.

The Quality Improvement Prototype (QIP) Award and The President's Award for Quality—both awards are established by the Federal Quality Institute to recognize federal organizations for delivering high standards of quality in their products and services. An organization which previously has been eligible for the Prototype award may also be eligible to apply for the President's Award for Quality. The latter represents a higher level of recognition, while the former represents models of total quality to the rest of the government. Winners of the QIP Award include a maximum of six Prototype organizations. A maximum of two winners are eligible for the President's award.

The George M. Low Trophy: NASA's Quality and Excellence Award—recognizes NASA aerospace industry contractors, subcontractors, and suppliers that consistently maintain and improve the quality of their products and services. The American Society for Quality Control (ASQC), a major quality organization, and NASA both assist in administering the award. The two award categories are large businesses and small businesses.

The Quality Cup—this national award, cosponsored by the Rochester Institute of Technology and USA Today, recognizes entire companies, divisions, departments, small teams and individuals which make significant contributions to the improvement of quality products and/or services. It is unique because it stresses that quality begins with the level of the individual. Awards will be given to individuals or teams in five categories: service firms; manufacturing firms; not-for-profit institutions; government units and government agencies; and organizations with fewer than 500 employees.

The Edwards Medal—recognizes an individual's outstanding leadership in the application of modern quality control methods, along with the administration and organization of such work. Every year, ASQC honors an individual who has made major contributions to the advancement of quality. Members of ASQC are asked to make nominations for this honor.

The British Quality Award*

The British Quality Award was established in 1984 to provide an incentive for total quality improvement in various organizations of the United Kingdom. The awards are organized and managed by the British Quality Association (BQA). BQA membership includes companies and organizations in the public and private sectors; manufacturing and service industries; governmental departments; professional, leisure and industrial associations; and education and research establishments. The Association is the United Kingdom's main source for information on both national and international quality activities. The two categories of recipients of the awards are the winning organizations and those who are "highly commended."

Objective of the Award

The goal of the British Quality Awards is to recognize the direct improvement in the quality of a product or service, and also to recognize the quality of management of the whole operation and how it relates to financial performance.

Eligibility Requirements

Membership in the British Quality Association is not a requirement for those applying for the awards. Any organization or group of individuals based in the United Kingdom may be considered, as long as the judges have a clear understanding of the identity and function of the group nominated. Those submitting applications must provide detailed information on the relationship between the whole organization and its parts.

Award Criteria

Since the first launching of the award in 1984, the criteria have been continuously improved. The judges have worked closely with the U.S. Malcolm Baldrige National Quality Award, and it is no wonder that this year's British Quality Award criteria reflect Baldrige:

1. *Customer satisfaction.* Knowledge of the customer, customer support system, responsiveness and ability to meet customer requirements and expectations. Evidence of current levels and trends in customer satisfaction is required.

2. *Leadership.* How the senior executives create and sustain a quality system within their corporate culture to guide activities of the organization, and demonstrate commitment to quality improvement, both internally and externally.

3. *Information and analysis.* Evidence of improvement in quality over a four-year period as demonstrated by: diagrams; defects, errors and complaints; supplier assessment; cost reduction; service calls, visits and costs; competitive benchmarking; and involvement of senior management and all levels of staff towards continuous quality improvement.

4. *Strategic quality planning.* The applicant must provide the basis of an overall quality planning process, which should include quality values and targets as milestones within a company's strategy.

5. *Human resource utilization.* Steps to develop, empower, and create an environment for all levels of staff for quality improvement.

6. *Quality assurance of products and service.* System used to control and give assurance on design and process. Submission should include achievements in quality development and programs.

7. *Quality results.* Quality levels achieved from the analysis of the business and how it relates to financial performance.

Application and Entry Requirements

Entry forms and guide notes for preparation are available on request from the Award Secretary of the BQA. Nominations are made by the chief executive of the applicant. A completed entry form and two copies of a detailed report on quality improvement must be submitted to the BQA. Submission should show evidence of an organization's improved performance over the previous four years based on a well-organized plan.

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* Source: *The British Quality Award Scheme 1992* and *Submission Guide Notes for The British Quality Award.*

Judging Process

A team of judges from all corporate sectors, government and academia are appointed annually by the BQA Board of Management to review written entries or in some cases to visit the organization. For specialized or highly technical entries, the judges are assisted by experts. A judge cannot participate in review of an entry form if he/she is associated with that group or organization. A judge's recommendations are subject to the approval of the President of the BQA.

The Awards

Each award winner receives a trophy and a certificate. The winners and entries awarded "high commencement" may also use the BQA logo on printed and promotional material. Rank Xerox of Welwyn Garden City, 3M United Kingdom plc, and IBM (UK) Ltd. of Greenock are among the 19 award winners from previous years. For 1992, the awards will be presented in London in November.

The Canada Awards for Business Excellence*

In 1984, the Canada Awards for Business Excellence (CABE) program was created by the Government of Canada to honor businesses in all industry sectors for their outstanding achievements. Over the years, different categories of business achievement have been chosen as focal points for award eligibility. The Award program for 1992 will spotlight eight categories: Entrepreneurship, Environment, Industrial Design, Innovation, Invention, Marketing, Small Business and Total Quality. Each of these categories have their own set of descriptions and eligibility criteria. Applying firms should review these details to determine which categories most closely match their achievements.

Many firms which apply for the awards report that preparation of the application is worthwhile for their organization's internal self-assessment. Preparation helps the company examine its strengths and present opportunities for further improvements. Focusing on a company's accomplishments also contributes to enhanced team spirit.

Objective of the Award

The goal of the CABE program is to recognize achievements in quality of a product or service. These achievements can enhance product development, leadership, product design, new technology, creativity, management, marketing, innovation and overall business quality through a commitment to continuous quality improvement. Such achievements may result in improved financial performance, where applicable.

Eligibility Requirements: Conditions of Participation

Those eligible include profit-making business enterprises or their business units located in Canada, in all fields of economic activity, i.e., natural resources, manufacturing and services. A business enterprise, either as a corporate entity or through any of its business units (company, division, branch or subsidiary) may apply. These firms may compete in as many categories as they wish, but may not enter more than once in the same category in any one year. The Invention category is the only one open to institutions (e.g., universities and research centers). The competition is not open to individuals, except in the Entrepreneurship category, which is only open to the owner-manager who retains a controlling interest in the business.

Category Questionnaire: Category Description, Eligibility Criteria and Questionnaire

Each category has its own focus, eligibility criteria and its own questionnaire. For example, although the Entrepreneurship and Small Business categories have some attributes in common, the former focuses on the *key individual* rather than on *the business as a whole*. The Invention and Innovation categories are also distinct and have eligibility criteria that preclude the same product, process or service being entered in both categories in the same year.

The Questionnaire section represents an award's criteria. Each category questionnaire contains its own set of guidelines pertaining to the business' background and up to five different criteria, each containing sub-categories. The weighting for each criterion is provided within the individual questionnaire. See box on pages 41-43, for sample layout of the Total Quality Category.

Application Submission and Entry Requirements

A separate entry form for application should be submitted for each category. Response for each entry include a one page summary, data tabulations, graphic displays, annual reports, financial statements, organization charts, promotional brochures, addresses of business location, major suppliers and customers, patents and photographs, and relevant industry information. Videos and slides are not acceptable. Organizations submitting entries for more than one category must enclose each entry in a separate envelope, but multiple entries may be shipped together. The original and three unbound copies of the completed entry form(s) and answers to the questionnaire(s) for each category are sent to Canada Awards For Business Excellence (CABE) in Ottawa. There are no fees involved for submission. Further information on the awards' program may be obtained from either CABE or regional offices of Industry, Science and Technology Canada in various cities such as Montreal, Toronto, Winnipeg and Alberta.

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* Source: *The Canada Awards for Business Excellence Entry Guide 1992.*

Judging Process

Independent panels are made up of private sector experts and senior business executives who aid in the selection of winners for each category. The selection process is rigorous because of the special characteristics of each category. Site examination is a requirement for the Quality and Environment categories. This examination is usually conducted by the Quality and Environment category panels assisted by site examiners. The jury panels meet to select the winners of all categories. Traditionally, the awards presentation is held in late October.

The Awards

The CABE trophy is represented as Canada's symbol of business excellence. Each category may have up to three trophy winners. Certificates of merit may also be awarded to those not winning a trophy. Benefits to the trophy winners include national and international media exposure, CABE logo (hexagonal emblem) for use on products and publications, a distributed booklet profiling winners, heightened employee morale, enhanced prestige within the business community, a competitive edge in domestic and foreign markets, and being the focus of research studies sponsored by CABE.

Some of the past winners for the 1991 categories include: Les Produits Verriers Novatech Inc. (Entrepreneurship); Eco-Tec Inc. (Environment); Black & Decker Canada (Industrial Design); Enermodal Engineering Limited (Innovation); Canada Wire and Cable Limited (Invention); Classy Formal Wear Inc. (Marketing); Chrysler Canada Ltd. (Quality); and Freda's Originals Inc. (Small Business).

TOTAL QUALITY*

Category Description

This award is given in recognition of outstanding achievement in overall business quality through a commitment to continuous quality improvement. Emphasis is placed upon the total involvement of the company, including all business functions and all employees, on the competitiveness of the products or services in the marketplace and on a high level of customer satisfaction.

Eligibility Criteria

The quality improvement achievement must have taken place within the last five years, with the achieved level of quality performance being sustained over time.

Please note:

1. Applications are restricted to **seventy-five pages** including charts and other information demonstrating the achievements. Supplementary information is defined in the section HOW TO ENTER (#4d).
2. Applicants for the Total Quality award short-listed for trophy winner consideration will be asked to accept a site visit by a team of examiners. The primary objective of the visit is to verify the information provided in the entries for this category. Approximately two weeks' notice will be given prior to these visits.

Selection Process

Submissions for the Total Quality category are evaluated by quality professionals and senior business executives chosen from across the country and from various business backgrounds.

The process of selection involves four distinct stages.

1. Preselection Committee

The six-member Preselection Committee is responsible for assessing the written submissions of all applicants; identifying strengths and opportunities for improvement; reviewing, discussing and ranking applications; selecting applicants to be visited; identifying items to be clarified during the visit; and completing the feedback to applicants which have not been short-listed.

2. Site Examiner Training

Above and beyond the quality expertise which examiners already possess, thorough training and "calibration exercises" are undertaken by all examiners to insure consistency in the interpretation of criteria, their approach to the site examination and their preparation of the report.

3. Site Examination Teams

Each Site Examination Team is composed of three or four members. Members are responsible for reviewing the applicant's submission and the assessment by the Preselection Committee to confirm site visit issues. The Lead Examiner is reponsible for setting the agenda for the site visit, for assigning resources to verify and clarify outstanding issues, for reaching a consensus on the team's findings and for submitting a report to the Jury Panel.

The membership of the teams varies and is not constant throughout. Each team reports on one applicant. To ensure impartiality, membership of the teams varies from applicant to applicant.

4. Jury Panel

The Jury Panel is composed of five senior executives from the private sector and is the only body to evaluate all information on applicants which have been visited. The jury is briefed on the evaluation criteria and the selection process to date. It reviews and discusses all short-listed applications and site visit reports, calling upon The Lead Examiner for clarification when needed.

After consideration of the above material, a consensus is developed regarding recipients of trophies and certificates of merit.

Conflict of Interest / Confidentiality

Strict conflict of interest and confidentiality rules apply throughout all stages of the selection process. Sensitive business information is protected under Section 20 of the *Access to Information Act*. All participants in the selection process are required to declare conflicts of interest and to sign binding confidentiality agreements.

* This exhibit does not represent the full layout for the Total Quality Category. Refer to the original source.

QUESTIONNAIRE

EVALUATION CRITERIA

The elements of response identified in this questionnaire are synonymous with the Total Quality Evaluation Criteria.

BUSINESS BACKGROUND

This information is important as it provides perspective on the challenges and achievements of the business.

i. Business Profile:

Briefly describe the business activities of the company, its industry sector and its competitive environment, including reference to major clients.

ii. Industry Comparison:

Identify how the business ranks in comparison with others in its industry sector, including major competitors and current and historic market share.

iii. Company Locations:

If the quality achievement involves more than one Canadian business location, attach a list showing the address, number of employees, contact name and telephone number for each site as supplementary information.

iv. Organization:

Provide an organization chart depicting the divisional/functional relationships of the areas of the company involved in the quality success story as supplementary information.

v. Major Customers and Suppliers:

Attach also as supplementary information a list of major customers and suppliers and include contact names, addresses and telephone and facsimile numbers.

VALUE

1. QUALITY IMPROVEMENT POLICY AND PLAN — 10%

1.a Policy and Definitions

Describe the company's policy for quality and state how and why it was developed and by whom; include the company's definition of quality improvement.

1.b Quality Improvement Plan and Development

Outline the quality improvement plan and how it was developed (stressing employee involvement) and describe how it was incorporated into the overall business plan. Describe how customer needs and expectations and suppliers were included in the quality plan.

1.c Planned Measurements of Quality

Describe how the quality of the key components of the product or service is measured.

2. IMPLEMENTATION OF POLICY AND PLAN — 40%

2.a Promulgation of Quality Policy

Describe the steps taken to ensure that management and all employees, suppliers and customers understand the content and the importance of the policy.

2.b Leadership, Deployment and Tracking

Describe the actions taken by the company to implement and operate the plan. Indicate the leadership shown by management, the involvement of employees, the extent of involvement of all business functions, and the measurements implemented to track improvement trends. Specify over what time period the plan was implemented.

2.c Customer Needs and Assurance of These Needs

Describe how the service or product definition, design and production activities are driven by the needs of customers. Include details of how the company ensures that suppliers will assist in satisfying the expectations of its customers.

2.d Employee Involvement, Coaching and Training

Describe the extent to which employees are involved in the implementation and operation of the quality improvement plan. Identify training and educational opportunities that are made available to them, and describe the extent to which management encourages and is responsive to their ideas and concerns.

2.e Innovative Quality Improvement Techniques

Describe any innovative actions or techniques developed to solve particular problems that have arisen in the implementation or operation of the plan. Also describe the extent to which such innovations have been shared with the industry at large and with suppliers.

3. RESULTS ACHIEVED 40%

3.a Product or Service Improvement and Customer Satisfaction

Describe the nature and extent of the improvement in quality in the product or service as a result of the plan. Quantitative and verifiable data which demonstrate **the improvement trends** are to be provided for the last three years and should be shown relative to other industries. Information collected through customer surveys, documented feedback, independent quality reports and the like on the level of customer satisfaction achieved will be particularly important. Evidence of employee participation and supplier involvement will also be considered.

3.b Further Results and Benefits

Describe how the company has benefited from the impementation of the quality improvement strategy, including such matters as trends in employee satisfaction and morale, productivity yields, operational losses (e.g., scrap, rework) and cycle times. Show their linkage to trends in overall business measures, such as market share, profits before tax, etc. Trend data should cover a three-year period and should be shown relative to other industries.

4. FUTURE PLANNING 10%

4.a Future Planning for Quality Improvement

Describe how experience with the existing quality improvement policy and plan is being incorporated in the future activities of the company. Indicate how customers, employees and suppliers are involved.

4.b Planning New Products or Services

Briefly describe how the company is using the results achieved in the planning, design and production/output of new services or products.

The Deming Prize*

For a number of years after World War II, Japan's main concern was to raise the standard of living through revitalization of its economy. One of the first steps to this goal was the adoption of statistical quality control methods by Japanese industry. Dr. W. Edwards Deming, American statistician and expert on total quality, was invited to present a series of lectures on the introduction and application of statistical quality control techniques. In 1951 the Board of Directors of the Japanese Union of Sçientists and Engineers (JUSE) instituted the Deming Prize in grateful recognition of Dr. W. Edwards Deming's achievements in the cause of industrial quality control. Until recently the Deming Prize was restricted to Japanese companies.

Objective of the Deming Prize

The goal of the Deming Prize is to recognize improvement of performance from successful implementation of company-wide or total quality control (CWQC or TQC) based on statistical quality control techniques.

Eligibility Requirements

Those eligible for Deming prizes include individuals who show excellent achievement in the theory or application of statistical quality control, or who make an outstanding contribution to its dissemination. Enterprises, divisions of enterprises, (including public institutions), and small- and medium-sized businesses are also considered eligible if they show distinctive improvement in performance, increased productivity and cost reduction through the application of statistical quality control.

In 1986, The Overseas Deming Prize was established by the Deming Prize Committee of JUSE due to the strong interest to validate implementation of total quality control among non-Japanese companies. If sufficient time is present upon completion of examinations in Japan, applications for non-Japanese companies are accepted, examined and awarded by the Committee. However, if the number of applicants exceeds the examination capability, some applications may be carried forward to the next year or later.

Award Criteria

The following examination items make up the award's criteria:

1. *Company policy and planning.* How the policy for management, quality and quality control is determined and transmitted throughout the company together with the results that are achieved, and whether the contents of the policy are appropriate and clearly presented.
2. *Organization and its management.* Whether the scope of responsibility and authority is clearly defined, how cooperation is promoted among all departments, and how the organization is managed to carry out quality control.
3. *Quality control education and dissemination.* How the concept of quality control is taught and statistical techniques are understood and utilized, and how employees are trained through courses and routine work in the company concerned.
4. *Collection, transmission and utilization of information on quality.* How the collection and dissemination of information on quality from within and outside the company are conducted by the head office, factories, branches, sales offices, and the organizational units; and how fast information is transmitted, sorted, analyzed and utilized.
5. *Analysis.* Whether or not critical problems regarding quality are being grasped and analyzed, and whether the results are being interpreted properly in the frame of the available technology and statistical methods.
6. *Standardization.* The establishment and revision of standards, the manner of their control and systematization, and the use of standards for the enhancement of company technology.
7. *Control.* How procedures used for the maintenance and improvement of quality are reviewed, and how the responsibility for and the authority over these

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* Source: *The Deming Prize Guide for Overseas Companies.*

matters are defined; examination of the use of control charts and related statistical techniques.

8. *Quality assurance.* Activities essential for quality assurance such as new product development, quality analysis, design, production, inspection, equipment maintenance, purchasing, sales, service, reliability.

9. *Effects.* What effects were produced or are being produced on the quality of products and services through the implementation of quality control; whether products of good quality are being manufactured and sold; whether products have been improved based on quality, quantity, and cost; and whether the whole company has been improved based on the effect of quality and profit, and the employees' motivation to work.

10. *Future plans.* Whether the strong and weak points in the present situation are properly recognized, and whether the promotion of quality control is planned in the future and is likely to continue.

Application and Entry Requirements

For companies that intend to apply, the Deming Prize Committee provides a consulting meeting to give advice and answer inquiries concerning examination procedures. Cost for consultation will be charged to the company. Requests for applications and completed entries are sent to the JUSE for both Japanese and overseas companies. An outline of background information on the applying firm or division is requested to accompany the application form. On receipt of application, a preliminary deliberation on its acceptability is held. Upon acceptance of application, the applicant must submit 20 copies of a "Description of Quality Control (QC) Practices," a company business prospectus, (both written in Japanese), and other forms of documentation if on-site inspection is applicable. If necessary, an English version of the QC Practices may be attached. QC practices are to be clearly described in line with the examination items of the award's criteria.

For those companies not ready to apply for the Deming Prize, the Deming Prize Committee offers to conduct diagnoses of their quality control programs. Companies undergoing diagnosis cannot apply for the award in the same year. There is a fee for conducting these diagnoses.

Judging Process

The Deming Prize Committee is responsible for the examination, selection and awarding of the Deming Prize. Members of the Committee consist of officers of organizations related to quality control. Subcommittees are formed under the Deming Prize Committee. Subcommittee members consist of university professors and quality control experts in government and other non-profit institutions responsible for selecting recipients of Deming prizes for their respective areas. Personnel of profit-making business enterprises are excluded from subcommittees.

Examination is conducted by the Application Prize Subcommittee, beginning with review of the applicant's contents of the "Description of QC Practices." If a review shows evidence of quality control being practiced efficiently throughout the company, then approval for on-site examination is granted. There are costs involved for on-site examination. On-site inspection will be performed at the units selected by the committee. There are three parts to on-site inspection: 1) Schedule A, which is the presentation of important points of quality control practices and a general explanation of the processes and methods of manage- ment by the applicant; 2) Schedule B, which is the on-site investigation and general interrogation; and 3) an interview with the CEO. If the applicant passes the on-site examination, the Deming Prize Committee decides whether or not to award a prize.

The Awards

There are three categories of awards. Winners of The Deming Application Prize for Individual Person and The Deming Application Prizes receive the Deming Medal and an accompanying certificate of merit. The Quality Control Award for Factory is another award winner. The Deming Application Prizes are classified as: the Prize, awarded to an enterprise or public institution; the Prize for Small Enterprise, awarded to a small or medium enterprise; and the Prize for Divisions, awarded to a division of an enterprise or a public institution. Winners of the Deming Prize for overseas companies are also awarded the medal and certificate. Prize winners are announced in Japanese newspapers and magazines.

The 1991 award winners for Japan include: Nec Kansai, Ltd., Nachi-Fujikoshi Corp., and Hokushin Industries, Inc. for the Deming Application Prize; Sin'ei Industries Co., Ltd. and Niigata Toppan Printing Co., Ltd. for the Deming Application Prize for Small Enterprise; and Aisin Aw Co., Ltd. for the Japan Quality Control Medal. The latter award is given to an applicant company which was already awarded a prize more than five years ago, excluding the prize for a division. The Deming Prize for Individual Person went to Dr. Kenji Kurogane. Recently, the Deming Application Prize for Oversea Companies has been awarded to Philips Taiwan Ltd. in 1991 and Florida Power and Light Company in the United States in 1989. The latest award winner for the Deming Application Prize for Divisions in Japan was Joban Kosan Co., Ltd., in 1988. The Quality Control Award for Factory went to Suntory Ltd., Yamanashi Winery back in 1990.

The European Quality Award*

Major European firms are beginning to realize that survival in today's globally competitive marketplace requires managing for total quality. Many of these companies have used total quality techniques to improve their management and business processes, realizing that quality is not confined solely to a product or service. It now applies to delivery, administration, customer service and every other aspect of the organization's activities. Evidence of increased competitiveness, reduced costs and greater satisfaction has been shown. In recognition of the total quality potential, 14 Western European companies took the initiative to establish the European Foundation for Quality Management (E.F.Q.M.) in 1988.

The purpose of E.F.Q.M. is to continually enhance the position of Western European businesses in the world market. This will be achieved through accelerating the acceptance of quality as a strategy for global competitiveness, and assisting the deployment of quality improvement activities. Membership in the E.F.Q.M. had grown to nearly 200 members from most Western European countries and most business sectors at the beginning of 1992.

Recognition of achievement is a feature of E.F.Q.M.'s policy. The Foundation's European Quality Award, which recognizes Western European companies for their successful achievements in total quality management, was officially launched in 1991 at the European Quality Management Forum in Paris. The European Quality Award will be presented for the first time in October 1992, during the Awards Ceremony at the European Quality Management Forum in Madrid, Spain.

Objective of the Award

The goal of the European Quality Award is to become the major instrument for supporting the successful management of total quality in European companies. The award aims to: recognize European organizations for their attention to total quality; encourage others to follow the example of a winning company; increase the level of awareness in society in general, and in business in particular, of the growing importance of quality to European standards of living and competitiveness.

Eligibility Requirements

European companies, subsidiaries or divisions that represent models of quality are eligible for the award. Eligible companies may be publicly- or privately-owned; European- and foreign-owned; joint ventures; incorporated firms; partnerships; sole proprietorships; or holding companies. Those not eligible include local, regional, national and government agencies; not-for-profit organizations; trade associations; and professional societies. Since this is an award for Western Europe, applicants must be able to demonstrate a history of significant commitment to at least 50 percent of their business operations in Western Europe for the past five years. A company must apply as a whole if it employs less than 500 people on a permanent basis. If a company has more than 500 employees, a division or subsidiary may apply as long as they operate independently from the parent company. The parent company and its units may not apply at the same time.

Award Criteria

Since 1990, over 300 Europeans from companies, academic institutions and professional organizations active in total quality management have been involved in determining the criteria for the European Quality Award. These criteria can be used to appraise the organization's progress toward total quality management, and are summarized in the European Quality Award Assessment Model with their weighted values (see chart).

The model has nine elements grouped under two heads: the "Enablers" and the "Results." The Results criteria are concerned with *what* the company has achieved and is achieving, and the Enablers criteria are

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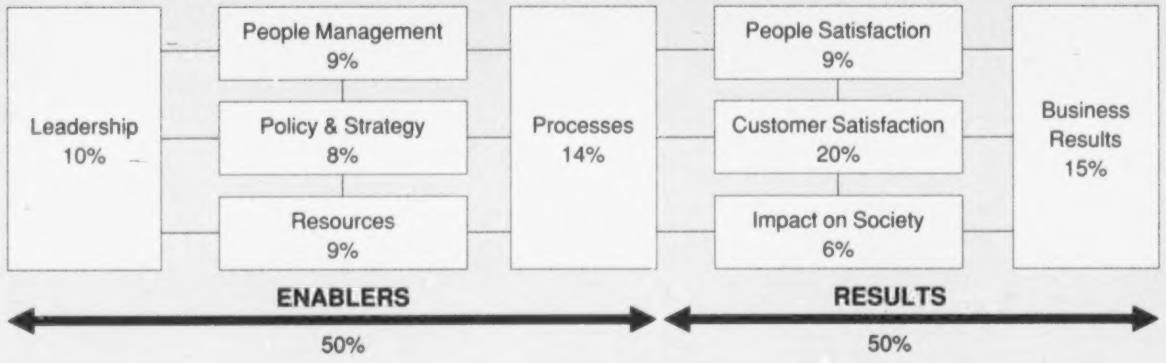
* Source: *The European Quality Award 1992 Guidelines for Application*

The European Quality Award Assessment Model

People, Processes and Results



concerned with *how* results are being achieved. The results section for application of the award should include charts and data to show significant trends in improved performance.

The Enablers criteria are:

Leadership. The behavior of all managers in driving the organization toward total quality. This section examines how the executive team and all other managers inspire and drive total quality as the organization's fundamental process for continuous improvement. Applicants must provide evidence of involvement in leading quality management; a consistent total quality culture; recognition and appreciation of the efforts and successes of individuals and teams; support of total quality by provision of appropriate resources and assistance; involvement with customers and suppliers; and the active promotion of quality management outside the company.

Policy and strategy. The organization's values, vision and strategic direction and the ways in which the organization achieves them. The focus is on how the organization incorporates the concept of total quality in the determination, communication, implementation, review and improvement of its policy and strategy. Applicants must document how policy and strategy are based on the concept of quality; developed on the basis of information that is relevant to total quality; meshed with business plans; communicated; and regularly reviewed and improved.

People management. The management of the organization's people. The emphasis in this section is on how the organization releases the full potential of its people to improve its business continuously. Required evidence includes how continuous improvement in people management is affected and how the company preserves and develops core skills through the recruitment, training and career progression of its people; sets performance targets and reviews them continuously with staff; and promotes the involvement of all its people in continuous improvement and empowers its people to take appropriate action.

Resources. The management, utilization and preservation of resources, based on the concept of quality. An organization must show how it improves its business continuously, by optimization of its financial, information, and material resources, and the application of technology.

Processes. The management of all the value-adding activities within the organization. This section explores how key and support processes are identified, reviewed and, if necessary, revised to ensure continuous improvement of the organization's business. The required evidence includes: how the key processes are identified; how the company systematically manages its key and support processes; how process-performance parameters, combined with other relevant feedback, are used to review key processes and to set targets for improvement; how the company stimulates innovation and creativity in process improvement; and how the company implements process changes and evaluates the benefits.

The Results criteria include:

Customer satisfaction. The perception that external customers, direct and indirect, have of the organization and of its products and services. The company must demonstrate its success in satisfying the needs and expectations of customers.

People satisfaction. Examines the people's feelings about their organization. The company must document its success in satisfying their needs and expectations.

Impact on society. Focuses on what the perception of the organization is among society at large; includes views of the organization's approach to quality of life, the environment and to the preservation of global resources. The company must demonstrate its success in satisfying the needs and expectations of the community at large.

Business results. Explores what the organization is achieving in relation to its planned business performance. The company must show continuing success in achieving its financial and other business targets and objectives, and in satisfying the needs and expectations of everyone with a financial interest in the company.

Application Submission and Entry Requirements

Before submission of the application, an applicant needs to conduct its own company self-appraisal. Self-appraisal involves the regular and systematic review of an organization's activities and results. If self-appraisal is successful, then a firm may decide to proceed with the application process.

Submission of application or requests for copies of brochures and blank application forms are sent to the European Quality Award's Secretariat at E.F.Q.M. in Brussels. The application should be divided into the following sections: title page; application form; table of contents; overview of the applicant in a two-page summary; and self-appraisal material, which comprises the vast majority of the application. This section may be submitted in the applicant's original language, provided it is clearly annotated and/or cross referenced in English. There is a fee when submitting an application.

The self-appraisal should cover performance within the last few years, and include those aspects which are or have been vital to both delivering and improving quality. To remain consistent with the evaluation process for the award, information submitted in the self-appraisal material section of the application must align with the award model and requirements.

Judging Process

A team of up to six assessors review a submitted application. Members of the panel of assessors are managers from companies in Europe who have experience with the U.S. Malcolm Baldrige National Quality Award assessment procedure. The application is scored on the basis of the self-appraisal data.

Following this assessment, the Award jury will decide which applicants should be visited for further examination. Jurors are selected from among senior managers, academics and professionals who are considered European practitioners in total quality management. The site visits involve the verification of the application and the inspection of the quality practices of the leading applicants. After the jury's final review and decision, the awards are presented to the companies that demonstrate the highest standards of total quality management.

The Awards

The Award for 1992 incorporates the *European Quality Prize* and *The European Quality Award.* The Quality Prize is awarded to a number of companies that demonstrate excellence in the *management* of quality as their fundamental process for continuous improvement. The Quality Award is awarded to the most successful representative of total quality management in Western Europe. An engraved trophy is presented to the European Quality Award recipient. All award winners are eligible to use the European Quality Award symbol and the European Prize symbol in their corporate material. In the year following the presentation of the Award, winners will share their experience of total quality management at E.F.Q.M. seminars. Those not winning a prize or the initial award will receive a feedback report that concentrates on improving a firm's approach to quality management.

The Excelsior Award*

The Excelsior Award, launched in 1991 for New York State, is among those state awards based on Baldrige criteria. It was presented for the first time in May 1992. Unlike the Baldrige Award which recognizes eligibility for organizations of the private sector only, the Excelsior Award encompasses eligibility for the public, private and education sectors.

Objective of the Award

The goals of the Excelsior Award are to: achieve excellence in quality of products and services and in the work force of an organization building upon a cooperative framework; improve the perception of public service at the local, county and state level, as well as the education community; motivate businesses and organizations to ensure world class operations; and set standards for self evaluation—bottom to top, top to bottom—of operational and human resource systems and processes. The award also serves as an economic development tool for attracting and retaining businesses and skilled workers, and a self assessment tool against which to evaluate present and future operations.

Eligibility Requirements

Up to six awards are given across the three sectors. The categories include: private sector-manufacturing and service; public sector-state government and local government; and education sector-private and public schools, colleges and universities.

The term "education sector" is defined as including an accredited school district or any governmental entity operating a public school, college or university. It also includes an independent/not-for-profit educational entity operating an accredited school, college, or university. The term "public sector" is defined as including: the State of New York; a county, city, town, village or any other political subdivision or civil division of the State; a public improvement or special district; a public authority, commission or public benefit corporation; or any other public corporation, agency or instrumentality or unit of government which exercises governmental powers under the laws of the State.

Eligibility in each category can be determined by using the Standard Industrial Codes or the Government and Education Function Codes found in the individual application guidelines for each sector. These guidelines also contain more specific definitions, a set of categories and eligibility requirements. Whatever the sectors, the rules preclude both an organizational unit and its parent organizations from applying in the same year. Only one organizational unit/division of an educational institution/organization may apply for an award in the same year in the same award category. Award winners are ineligible to apply for another award for three years.

Eligibility is based on an applicant's size, its constituents and/or clients, organizational unit status and its relationship to a parent organization, and the functions it performs. School districts or other governmental entities operating a public school, college or university may apply in the education award category only.

The education sector and the public sector are each eligible for two awards, covering large and small entity categories. The large entities include 500 or more employees. This may apply to the total entity or a major segment/school/organizational unit that reports directly to the chief administrative/chief operating officer for the education sector or for local government in the public sector. For large entities of state government, an organizational unit reports directly to the highest appointed or elected official, otherwise the same conditions apply. The small entities include less than 500 employees, and this applies only to the total entity.

Award eligibility for the private sector is available to manufacturing and service firms and subsidiaries. "Subsidiary" is an umbrella term which includes an actual subsidiary, business unit, division, or like organization. Any for-profit business located in New York State may apply for the award. This includes those publicly- or privately-owned, domestic- or foreign-owned, joint ventures, incorporated firms, sole proprietor-ships, partnerships, and holding companies. Not-for-profit organizations, trade associations and professional societies are ineligible for application.

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* Source: *The New York State Excelsior Award Guidelines* for the Public, Private and Education sectors.

Large and small private sector organizations are eligible with "large" defined as 101 employees or more and "small" defined as 100 employees or less. A manufacturing company is eligible if it produces and sells manufactured products or manufacturing processes or produces agricultural, mining or construction products. A service firm must sell its services. Application conditions and restrictions apply for subsidiaries. They must have existed one year prior to application, have a clear definition of organization as reflected in corporate literature, have more than 100 full time employees and must have 20 percent of all employees in the worldwide operations of the parent company. To be eligible, subsidiaries must also function as independent units with their own multifunctional operations such as sales, marketing, engineering, human resource and other support functions. Subsidiaries may not apply if they are part of a "small" organization. Further information on conditions and restrictions on subsidiaries can be found in the private sector guidelines.

The Award Criteria

Whatever the sector, the criteria for this award and their application are Baldrige based. Integration of these criteria is achieved through numerous direct and indirect relationships among examination items. The seven examination categories each contain two or more examination items for a total of 33. Each examination item includes a set of "areas to address," which illustrates and clarifies the intent of the items. Applicants are required to provide information about their quality management system, methods, and results using this framework. Please refer to the boxes on pages 51 and 52 for each sector's seven categories, examination items and their values.

The initial examination process is made up of a two-part diagnostic procedure including the examination items and the scoring system. The items represent what is to be evaluated and the scoring system represents how the evaluations are made. The following is a summary of the seven examination categories and how they are used in evaluating the quality process in private sector companies, public sector agencies and educational institutions of any size or type.

1. *Leadership.* An applicant must show how senior executives create and sustain clear and visible quality values, along with a management system to guide all activities of the educational institution/company/organization toward quality excellence. Partnering is examined to determine senior executives' attitudes and involvement with labor-management partnering arrangements which support high-performance work systems. Senior executive and company quality leadership in the external community and a demonstration of how the company integrates its public responsibilities with its quality values and practices are also required.

2. *Information and analysis.* An applicant must document the scope and validity of data and information that is used for day-to-day management and planning within an overall total quality management process. Also required is the adequacy of the data, information and analysis to support a responsive, prevention-based approach to quality, constituency and customer satisfaction. Companies/organizations/institutions should be able to describe their approaches to selecting quality-related competitive comparisons and world-class benchmarks/highest attainable standards to support quality planning, evaluation, and improvement.

3. *Strategic/organizational quality planning.* An applicant must describe its strategic planning process for short-term and long-term quality leadership and constituent/customer satisfaction in relation to its competitive environment and resources of the organization. An organization/institution/company must document how its strategic planning processes and goal-setting are evaluated and improved, and how it integrates quality improvement planning into overall business planning.

4. *Human resource excellence.* The company/ institution/organization must document how its overall human resource management effort supports its quality objectives. Included in this effort is the effectiveness of the applicant to develop and realize the full potential of the entire work force. The applicant should provide: the types of education and training received by all employees and how they are utilized; summaries of trends in recognition and performance measurement processes; summaries of trends in well-being and morale, which should maintain an environment conducive to full participation, quality leadership, and personal and organizational growth; and how diversity issues in the workplace are addressed.

5. *Quality assurance of products/programs and services.* The applicant must show how it uses systematic approaches for assuring quality of products, programs, initiatives and services based upon process design and control, including control of procured materials, parts and services. Also required is how the processes used to produce products and services are continuously improved. The application of quality assessment for an applicant's systems, processes, practices, products, and services is also required. Another focus is how quality of materials and services furnished by suppliers are assured, assessed and improved.

6. *Quality results.* The applicant must document its trends in quality improvement and current quality levels, along with those of its competitors or other similar

The Excelsior Award

Public and Education Sectors

1992 Examination Categories/Items			*Maximum Points*
1.0	**Leadership**		**170**
1.1	Senior Executive Leadership	50	
1.2	Partnering	40	
1.3	Organizational and Quality Values	20	
1.4	Management for Quality	30	
1.5	Community Outreach	30	
2.0	**Information and Analysis**		**40**
2.1	Scope and Management of Quality Data & Information	10	
2.2	Comparisons	20	
2.3	Analysis of Quality Data and Information	10	
3.0	**Organizational Planning**		**40**
3.1	Organizational Planning Process	20	
3.2	Quality Goals and Plans	20	
4.0	**Human Resource Excellence**		**250**
4.1	Human Resource Management	30	
4.2	Employee Involvement	50	
4.3	Education and Training	50	
4.4	Employee Recognition and Performance Measurement	40	
4.5	Employee Well-Being and Morale	40	
4.6	Diversity and Human Potential Enhancement	40	
5.0	**Quality Assurance of Programs and Services**		**100**
5.1	Development and Introduction of Quality Programs & Services	25	
5.2	Process Quality Control	15	
5.3	Continuous Improvement of Processes	15	
5.4	Quality Assessment	15	
5.5	Documentation	10	
5.6	Administrative Process, Procedure & Quality Support Services	10	
5.7	Supplier Quality	10	
6.0	**Quality Results**		**150**
6.1	Program and Service Quality Results	100	
6.2	Administrative Process, Operational & Support Service Quality Results	25	
6.3	Supplier Quality Results	25	
7.0	**Constituent Satisfaction**		**250**
7.1	Determining Constituent Requirements and Expectations	25	
7.2	Constituent Relationship Management	40	
7.3	Constituent Service Standards	10	
7.4	Commitment to the Constituency	10	
7.5	Complaint Resolution for Quality Improvement	20	
7.6	Determining Constituent Satisfaction	15	
7.7	Constituent Satisfaction Results	60	
7.8	Constituent Satisfaction Comparison	70	
	TOTAL POINTS		**1000**

The Excelsior Award

Private Sector

1992 Examination Categories/Items			*Maximum Points*
1.0	**Leadership**		**170**
1.1	Senior Executive Leadership	50	
1.2	Quality Values	20	
1.3	Management for Quality	30	
1.4	Public Responsibility	30	
1.5	Partnering	40	
2.0	**Information and Analysis**		**40**
2.1	Scope & Management of Quality Data & Information	10	
2.2	Competitive Comparisons and Benchmarks	20	
2.3	Analysis of Quality Data and Information	10	
3.0	**Strategic Quality Planning**		**40**
3.1	Strategic Quality Planning Process	20	
3.2	Quality Goals and Plans	20	
4.0	**Human Resource Excellence**		**250**
4.1	Human Resource Management	30	
4.2	Employee Involvement	30	
4.3	Education and Training	50	
4.4	Employee Recognition and Performance Measurement	40	
4.5	Employee Well-Being and Morale	40	
4.6	Diversity	30	
4.7	Employee Partnering	30	
5.0	**Quality Assurance of Projects and Services**		**100**
5.1	Design & Introduction of Quality Projects & Services	25	
5.2	Process Quality Control	15	
5.3	Continuous Improvement of Processes	15	
5.4	Quality Assessment	15	
5.5	Documentation	10	
5.6	Business Process and Support Service Quality	10	
5.7	Supplier Quality	10	
6.0	**Quality Results**		**150**
6.1	Product and Service Quality Results	80	
6.2	Business Process, Operational and Support Service Quality Results	40	
6.3	Supplier Quality Results	30	
7.0	**Customer Satisfaction**		**250**
7.1	Determining Customer Requirements and Expectations	25	
7.2	Customer Relationship Management	40	
7.3	Customer Service Standards	10	
7.4	Commitment to Customers	10	
7.5	Complaint Resolution for Quality Improvement	20	
7.6	Determining Customer Satisfaction	15	
7.7	Customer Satisfaction Results	60	
7.8	Customer Satisfaction Comparisons	70	
	TOTAL POINTS		**1000**

providers. Also included are trends in quality of administrative processes, operations, and support services and trends in quality of suppliers and services furnished by other companies/institutions/organizations, along with those of its competitors and possibly key benchmarks.

7. *Customer/constituent satisfaction.* An applicant must document its knowledge of the customer/ constituent and an overall service system. The applicant must also determine current and future customer/client /constituent requirements and expectations and how it also provides for effective customer/constituent relationship management. Further description on behalf of the applicant includes: the standards governing the direct contact between its employees and customers/constituents and how these standards are modified; commitments to customers/constituents on promises underlying its products and services; how the applicant handles complaints, resolves them and uses complaint information for quality improvement and prevention; methods for determining how satisfaction information is used in quality improvement and how these methods are improved; trends showing customer/constituent satisfaction and adverse customer responses; and the comparison of customer/constituent satisfaction results and recognition with those of competitors that provide similar products and services.

Submission and Entry Requirements

Complete assembly of the application includes a title page, eligibility determination form, application form, site listing and descriptions form, the examination's table of contents, two-page overview of the applicant and details of the examination categories, items and areas to address. An eligibility determination form is required prior to submitting a completed application. Decision on eligibility will be forwarded to the applicant upon review of this form. Pictures, graphs, figures, data tables, and appendices can also be included for application. Trend data should demonstrate progress and show sustained improvement in quality over a period of five years or more. However, improvement efforts could be established much sooner. Fees are part of the application process. Information regarding application packages can be addressed to the New York State Department of Labor in Albany.

Judging Process and The Award

Judges, Examiners and Senior Examiners are selected by the Governor's Statewide Labor-Management Committee to review all applications and conduct multiple evaluations. These judges and examiners are selected from all sectors and are experts in their field who meet the highest standards of qualifications and peer recognition. The Governor's Statewide Labor-Management Committee, chaired by the Lt. Governor, has prime responsibility for the award. This committee brings together the leaders of six state agencies, the president of the New York State AFL-CIO, and the president of The Business Council of New York State, Inc.

The application reviews and evaluations are done in three steps: initial review, consensus review and site visits. The judges consider the organization's scores, scoring profiles and details of strengths and areas for improvement during the application review. The scoring system is based upon three evaluation dimensions known as approach, deployment and results. All examination items require applicants to furnish information relating to one or more of these components. Site visits are made to those applicants with the highest scores. Feedback reports are given to all applicants after the award ceremony. These reports cover the applicants' strengths, areas for improvement and overall performance in meeting with quality standards. Recipients of the 1992 Excelsior Award have been officially announced and include: Kenmore School District, education sector; New York State Police, public sector; Albany International and Motorola, Inc. (division of Elma, Buffalo), private sector.

References

For more information concerning these quality award programs, please contact the following sources:

The Shingo Prize

The Shingo Prize
College of Business
Utah State University
Logan, Utah 84322-3521
Tel: (801) 750-2279
Fax: (801) 750-3440

ITAA Quality Award

Doug Jerger
ITAA Quality Award Program
1616 North Fort Myer Drive, Suite 1300
Arlington, Virginia 22209-9998
Tel: (703) 284-5321
Fax: (703) 525-2279

The Quality Improvement Prototype (QIP) Award and **The President's Award for Quality**

Dick O'Brien or Victoria Elder
Federal Quality Institute
P.O. Box 99
Washington, D.C. 20044-0099
Tel: (202) 376-3747

The Edwards Medal and
The George M. Low Trophy

The American Society for Quality Control, Inc.
310 West Wisconsin Avenue
P.O. Box 3005
Milwaukee, Wisconsin 53201-3005
Tel: (414) 272-8575 or (800) 248-1946

The Quality Cup

Quality Cup
c/o Carol Skalski
USA Today
1000 Wilson Boulevard, 22nd Floor
Arlington, Virginia 22229
Tel: (703) 276-5890 or (800) 356-5650

The British Quality Award

The Award Secretary
The British Quality Association
10 Grosvenor Gardens
GB-London SW1W ODQ
United Kingdom
Tel: (44) 71-823-5608
Fax: (44) 71-824-8030

Canada Awards For Business Excellence

Canada Awards For Business Excellence
Services to Business Branch Industry,
Science and Technology Canada
235 Queen Street
Ottawa, Ontario K1A 0H5
Canada
Tel: (613) 954-4079
Fax: (613) 954-4074

The Deming Prize

Mr. Junji Noguchi
Executive Director
Union of Japanese Scientists and Engineers
5-10-11 Sendagaya
Shibuya-ku, Tokyo 151
Japan
Tel: (81) 33-352-2231
Fax: (81) 33-225-1813

The European Quality Award

Roy Peacock
Programme Manager Recognition
European Foundation for Quality Management
Eastbourne A.M.C.
Selwyn Road
Eastbourne, East Sussex BN21 21B
United Kingdom
Tel: (44) 32-3 642 905
Fax: (44) 32-3 642 491

New York State Excelsior Award

The Excelsior Award
New York State Department of Labor
Averell Harriman State Office Campus
Building 12, Room 540A
Albany, New York 12240
Tel: (518) 457-6743

or

The Excelsior Award
New York State Department of Economic Development
Industrial Effectiveness Program
One Commerce Plaza
Albany, New York 12245
Tel: (518) 474-1131

Related Conference Board Publications

Small Group Incentives: Goal-Based Pay, Report No. 1007, 1992

Leadership and Empowerment for Total Quality, Report No. 992, 1992

Baldrige Winners on World-Class Quality, Report No. 990, 1992

Maintaining the Total Quality Advantage, Report No. 979, 1991

Employee Buy-In to Total Quality, Report No. 974, 1991

Total Quality Management, Report No. 963, 1991

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